

Mergers, Acquisitions and Restructuring: Types, Regulation, and Patterns of Practice

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John C. Coates IV
Harvard Law School

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Abstract

An important component of corporate governance is the regulation of significant transactions – mergers, acquisitions, and restructuring. This paper (a chapter in Oxford Handbook on Corporate Law and Governance, forthcoming) reviews how M&A and restructuring are regulated by corporate and securities law, listing standards, antitrust and foreign investment law, and industry-specific regulation. Drawing on real-world examples from the world's two largest M&A markets (the US and the UK) and a representative developing nation (India), major types of M&A transactions are reviewed, and six goals of M&A regulation are summarized – to (1) clarify authority, (2) reduce costs, (3) constrain conflicts of interest, (4) protect dispersed owners, (5) deter looting, asset-stripping and excessive leverage, and (6) cope with side effects. Modes of regulation either (a) facilitate M&A – collective action and call-right statutes – or (b) constrain M&A – disclosure laws, approval requirements, augmented duties, fairness requirements, regulation of terms, process and deal-related debt, and bans or structural limits. The paper synthesizes empirical research on types of transactions chosen, effects of law on M&A, and effects of M&A. Throughout, similarities and differences across transaction types and countries are noted. The paper concludes with observations about what these variations imply and how law affects economic activity.

Keywords: Mergers, Acquisitions, Restructuring, Corporate Law and Governance, Corporate Law, Securities Law, Listing Standards, Antitrust and Foreign Investment Law

JEL Classifications: D23, D70, D82, F21, G32, G34, G38, K21, K22, K23, K41

John C. Coates IV*
John F. Cogan, Jr. Professor of Law and Economics
Harvard Law School
1875 Cambridge Street
Cambridge, MA 02138, United States
phone: 617-496-4420
e-mail: jcoates@law.harvard.edu

*Corresponding Author

Mergers, Acquisitions and Restructuring: Types, Regulation, and Patterns of Practice

John C. Coates IV¹

The core goal of corporate law and governance is to improve outcomes for participants in businesses organized as corporations, and for society, relative to what could be achieved through contract, property and other, less “regulatory” bodies of law. One way that corporate law and governance achieves that goal is to regulate significant transactions – particularly mergers, acquisitions, and restructuring, with an eye towards the two core values served by fiduciary duty doctrines: to ensure care and loyalty on the part of corporate decision-makers. This chapter of the *Oxford Handbook on Corporate Law and Governance* considers ways in which M&A – which will be the chapter’s short-hand for the general class of significant corporate transactions, including restructuring – is specially regulated, both within the formal body of corporate law and as that law interacts with other bodies of law, particularly securities (including listing standards), antitrust, industry-specific regulation, and regulations of cross-border transactions.

The chapter proceeds as follows. *First*, the concepts of “M&A” and “restructuring” are defined, and they are distinguished from other corporate transactions or activities. *Second*, major types of M&A transactions are briefly reviewed, using recent examples to illustrate the choices M&A participants have for effecting an M&A transaction. *Third*, the core goals of regulation are sketched:²

1. To clarify authority and control over M&A by corporate decision-makers;
2. To reduce transaction costs and overcome collective action problems;
3. To constrain and improve outcomes of conflict-of-interest transactions;
4. To protect dispersed owners of public companies;
5. To deter or mitigate looting, asset-stripping and excessive M&A-related leverage; and
6. To cope with the side effects of other regulations.

¹ *John F. Cogan Professor of Law and Economics*, Harvard Law School. Copyright John C. Coates IV; all rights reserved. Thanks for research assistance to Jason Wasser. For disclosure of financial interests potentially relevant to this article, see www.law.harvard.edu/faculty/COI/2013CoatesJohn.html.

² The emphasis here is on how *corporate law and governance* go beyond background contract, tort and property law in the M&A context. Important practical regularities in how those bodies of law are deployed in M&A – for example, contract clauses allocating risk, managing disputes, or redressing fraud – are neglected in this chapter, even though they are as important as the topics covered here. For more on those topics, see John C. Coates IV, *Managing Disputes Through Contract: Evidence from M&A*, 2 *Harv. Bus. Rev.* 301 (2012); Evidence-based M&A: Less Can Be More When Allocating Risk in Deal Contracts, 27 *Journal of International Banking, Finance and Law* 708 (2012); and Contracting to Lie: A Discussion of *Abry Partners v. F & W Acquisition* (Del.Ch. 2006), Legalworks 22nd Annual Mergers & Acquisitions Institute (May 17, 2006), available at <http://bit.ly/U7dum> (last visited June 2, 2014). Also not addressed are insolvency and bankruptcy laws, which often have important effects on restructuring transactions, and M&A conducted by insolvent companies.

In addition to these corporate law or governance related goals, M&A transactions face special treatment under other bodies of law (antitrust, industry-based regulation, regulation of foreign ownership of business, and tax) that sometimes interact with corporate law and governance, and the goals of these laws as applied to M&A are also briefly reviewed. *Fourth*, the modes of regulation are summarized, dividing laws or regulations into those that constrain M&A transactions and those that facilitate them. *Fifth* and finally, empirical research is summarized to present the different types of transactions that are actually chosen and (where available) what effects the laws that apply to them have in the world's two largest M&A markets (the US and the UK) and (as a contrasting example, and more selectively, given data limitations) in a developing nation (India), which now accounts for ~4% of global M&A. Throughout, the chapter notes similarities and differences of the choices and modes of regulation across transaction types and countries.

The chapter concludes with more general observations about what these variations in types and modes imply. Some differences, for example, seem to reflect long-standing differences in deep structural features of the markets (such as ownership structure). But other differences seem to reflect the way that (as in chaotic systems) seemingly small differences in starting conditions can ramify and persist in the face of otherwise generally similar conditions and strong market pressures. Minor variations in similar laws with similar goals in similar legal systems, in other words, can have real effects on the amount and nature of economic activity.

I. Terminology and scope: what are M&A and restructuring transactions?

The concepts “mergers and acquisitions” (M&A) and “restructuring” are primarily used as business terms, not as legal terms of art. They are not sharply defined, instead referring to fuzzy sets of similar transactions. As commonly understood by practitioners and used in this chapter, the core of M&A is a *deliberate transfer of control and ownership of a business* organized in one or more corporations.³ “*Restructuring*” is a *deliberate, significant and unusual alteration in the organization and operations of a business*, commonly in times of financial or operational distress, typically accompanied by changes in ownership or finance, as when a company merges two divisions, or sells off a business unit.

M&A and restructuring commonly occur together, and can bleed into one another, as well as other, unusual but less dramatic business decisions: bulk sales of inventory, organic growth through advertising campaigns, office closures, layoffs, and so on. M&A differs from those events, and from restructuring, in that M&A typically refers to the transfer of control of a business as an *entirety*, even if the buyer may consequently choose to restructure the target or itself. Restructuring differs from ordinary business events in that it is more significant, disruptive of prior operations and strategy, and not part of ongoing or routine business

³ Throughout, the chapter refers to “corporations” as a stand-in for the various types of corporate entities, including partnerships.

activity. M&A and restructuring are commonly accompanied by changes or transactions in capital (borrowing, buybacks, stock sales, etc.), either as part of the transactions or in parallel, but differ in that they change fundamental business operations and not purely finance.

M&A and restructuring are the most important transactions an incorporated business can undertake, rivaled only by initial organization or liquidation. The combination of change on multiple dimensions with deliberation and importance gives these transactions their characteristic drama and complexity. Their importance and complexity also makes them challenging for corporate law and governance.

Characteristically, M&A transactions involve a purchaser or buyer and a seller. The business being transferred is commonly called the “target,” which may be separately incorporated, or may consist of an operating unit or division – a collection of assets, employees, relationships, etc. – owned along with other businesses by a single entity. In some M&A transactions, however, there is no clear purchaser or seller – two companies combine their assets in what is commonly called a “*merger of equals*.”⁴

II. What are the major types of M&A transactions?

M&A transactions fall into a variety of types. A standard typology focuses on the legal nature of the transaction, dividing M&A into *asset purchases*, *stock purchases*, and *mergers* (or schemes of arrangement). The most primitive M&A transaction consists simply of the purchase of all of the assets used in (and so control over) a business. Where the target sells all of its assets, it typically then liquidates or otherwise distributes the price paid to its owners. (Something must also be done about the target’s liabilities, of course; the buyer may assume them, or they may be paid in the target’s liquidation, or they may be maintained in force if the target retains the price paid for its assets, or some combination.) In May 2007, for example, iStar Financial purchased Freemont Investment’s commercial real estate mortgage lending business of, and the parties structured their deal as a purchase of assets for \$1.9 billion in cash, with liabilities of the target divided between the buyer and seller.⁵

Where target assets are extensive, complex, or hard to specify, or their transfer is subject to regulatory requirements, or contract consents – think of the purchase of the individual assets of a company such as Barclays or Citigroup – asset purchases can be cumbersome, time-consuming and lengthy. The corporate form creates a simple, and often vastly simpler, alternative: a buyer can purchase all of the stock (and thus control) of the corporation that

⁴ Julie Wulf, Do CEOs in Mergers Trade Power for Premium? Evidence from “Mergers of Equals,” 20 J. L. Econ. & Org. 60-101 (2004) (analyzing such transactions).

⁵ <http://1.usa.gov/1roU57G> (last visited May 30, 2014).

owns a business, rather than its assets. AT&T's attempted acquisition of T-Mobile from Deutsche Telekom in 2011 was structured as a stock purchase.⁶

In India, stock purchases represent the dominant type of M&A transaction, followed by asset purchases, because ownership is typically concentrated in the hands of a single or small number of related shareholders, even when a target company is listed. In the five-year period ending 2008, for example, the average stake transferred in a domestic Indian M&A deal was only 53%, and in cross-border deals, involving a foreign bidder, only 16% of deals involved a 100% acquisition – a feature of the Indian M&A market partly explained by India's extensive regulation of foreign ownership of Indian companies, discussed more below. Examples of partial in-bound acquisitions include Vodafone's acquisition of 67% of Hutchison and Vedanta's acquisition of 59% of Cairn India.

When a target corporation has more than a small number of shareholders and the goal of the buyer is to obtain 100% ownership, stock purchases begin to increase transaction costs, making a simpler method of purchasing ownership more attractive. In the US, this is accomplished through the use of statutorily authorized mergers. Other statutory mechanisms exist in the US – consolidations, mandatory share exchanges, etc. – but mergers are the most straightforward and by operation of law result in the transfer of assets of one corporation to another, without the need to specify or purchase individual assets, and through which all owners have their stock converted into an agreed-upon form of “currency” or deal consideration (cash, stock of the buyer, etc.).

Commonly, it is desirable for purchasers to create new subsidiary corporations to carry out an acquisition. If done by merger, the resulting “triangle” of companies (parent/buyer, acquisition subsidiary, and target company) are described as having engaged in a “*triangular*” merger (target into subsidiary being called “forward” and the reverse being called “reverse”). AT&T's May 2014 agreement to buy DirecTV is structured as a forward triangular merger;⁷ Comcast's February 2014 agreement to buy Time Warner Cable is structured as a reverse triangular merger.⁸

In the UK and India, a similar result can be obtained through what is termed a “*scheme of arrangement*.” Vodafone's April 2012 offer for Cable & Wireless was effected as a scheme of arrangement;⁹ an example from India is the combination of Centurion Bank with HDFC Bank in 2008.¹⁰ More commonly in the UK (and to a lesser extent in the US), a purchaser can achieve a similar result by making a public “*bid*” (or “*tender offer*”) for the target's stock –

⁶ <http://1.usa.gov/1oShgDg> (last visited May 30, 2014).

⁷ <http://1.usa.gov/1nApnqH> (last visited May 30, 2014).

⁸ <http://1.usa.gov/1mQipKJ> (last visited May 30, 2014).

⁹ <http://bit.ly/1o67v30> (last visited May 30, 2014).

¹⁰ <http://1.usa.gov/1ixfh2o> (last visited June 13, 2014).

that is, to use the tools of mass communication to offer to buy stock of multiple shares simultaneously, at a set price with a specified currency. This enables the stock purchase to occur more cheaply than could be done through individual shareholder-by-shareholder purchases. Kraft's January 2010 acquisition for Cadbury was structured as a bid.¹¹

In a bid or tender offer, some shareholders may not tender, either because they (sincerely or strategically) choose to "hold out" for a higher price, or because they may not be aware of the offer (despite the bidder's best efforts at publicity) or even that they own the relevant stock (suppose the shareholder has a diversified portfolio and is traveling or busy and has failed to delegate authority over her stock dealings to a responsible agent). In that case, some statutorily authorized transaction – a "*freeze out*" or "*squeeze out*," as they are often called – amounting economically to the equivalent of a call option on the stock may be necessary to convey 100% ownership of the target (and its businesses). The transaction thus consists of two formal steps – bid plus squeeze-out – that produce the same result as a reverse triangular merger or scheme of arrangement.¹² Another step that might precede or fall between those steps is an initial stock purchase by the buyer from the target, or from selling shareholders of the target. Freeze-outs also sometimes occur outside the context of an arm's-length acquisition, as when a controlling shareholder or parent company freezes-out a minority stake in a controlled public subsidiary, generally pursuant to a single-step merger.¹³ The freeze-out of public investors in Levi-Strauss in 1996 by the Haas family is an example.¹⁴

In addition to these basic types of M&A transactions, there are other types, less common but not uncommon. In a "*spin-off*," ownership interests in one business are distributed to shareholders of a company that retains other businesses, resulting in a transfer of effective control to a newly constituted board and management of the "spinco," and transfer of ownership to the shareholders of the spinning corporation – followed typically by a divergence over time in the ownership of the two companies. Alternatively, a company can place one business in a corporation and sell its stock to the public for cash. Or these can be combined, with an initial "*carve-out*" followed by a spin-off. More complexity is possible and not uncommon. A new company can be created, along with two subsidiaries, and each of two separate companies can merge with each subsidiary (a "*top-hat*" or "*double dummy*")

¹¹ <http://bit.ly/1kIM36a> (last visited June 8, 2014).

¹² Id. ("Kraft Foods is today commencing the procedure under Chapter 3 of Part 28 of the 2006 Act to acquire compulsorily all of the outstanding Cadbury Shares ... which it does not already hold or has not already acquired contracted to acquire or in respect of which it has not already received valid acceptances"); <http://1.usa.gov/1nwPtYF> (Amgen tender offer document dated September 3, 2013 describing agreement with target Onyx Pharmaceuticals, Inc. pursuant to which Amgen would acquire 50% of Onyx's shares in the tender offer, followed by a freeze-out merger to acquire the remaining shares).

¹³ E.g., <http://1.usa.gov/1picRfi> (Form 8-K filed by PepsiCo. announcing freeze-out mergers between it and two controlled public subsidiaries) (last visited June 9, 2014).

¹⁴ <http://1.usa.gov/SkxYiM> (May 30, 2104) (SEC filing describing Levi-Strauss transaction).

structure).¹⁵ It is possible to combine three separate businesses at once in a new single enterprise, through a combination of the above simple legal types, or to transfer control and ownership of one company followed immediately by a further resale, spin-off or carve-out (or both) of one of that company's businesses.

Larger businesses are not typically organized as single companies, but as holding companies with multiple subsidiaries in multiple layers. (Morgan Stanley has ~2,800 subsidiaries, for example, and is not the most complex financial institution in the world.¹⁶) As a result, it is common for the buyer in an M&A transaction to want – after the initial “main” transaction – to want to move pieces of the target's business (often in multiple subsidiaries) into multiple subsidiaries of the purchaser, so as to achieve economies, avoid or reduce the costs of regulation, or for other reasons. As a result, the overall M&A transaction may take many steps. In Bank of America's acquisition of Countrywide, it used an initial forward triangular merger, followed by at least three sets of major stock or asset purchases at the subsidiary level, taking place over more than a year.¹⁷

M&A transactions also use a variety of types of “currencies” or forms of consideration. Cash is common, as is stock of the buyer. Buyers can also “pay” the target's owners with their own debt, i.e., promise to pay cash later – something commonly referred to as “seller financing,” or by exchanging assets for assets, or by assuming debt of the target or the seller. Forms of currency can be mixed, as in a one-step fixed blend (e.g., 50% cash, 50% stock), or by using all cash in one step, followed by all stock in a second step, or by offering target shareholders a choice, perhaps constrained by specified limits.¹⁸ If non-cash is used and the transaction involves delay between the moment the parties agree upon a price and the completion of the transaction, the value of the non-cash currency can fluctuate or can be fixed by contract. Deal currency is a separate choice from the legal form of the transaction – so asset purchases can be for cash or stock, as can stock purchases, mergers, and bids.

A final way to break down M&A transactions by type is by the nature of the parties or financing for the deal. Targets and buyers alike can have a single or small set of shareholders – “*private*” companies – or dispersed owners with stock listed on an exchange – “*public*”

¹⁵ In the acquisition of NYSE Euronext by IntercontinentalExchange in 2013, such a structure was provided for as an alternative to the initial structure, to be used if certain conditions were not met. <http://1.usa.gov/1pESZjA> (last visited May 30, 2014).

¹⁶ DAFNA AVRAHAM, PATRICIA SELVAGGI, AND JAMES VICKERY, FEDERAL RESERVE BANK OF NEW YORK, A STRUCTURAL VIEW OF U.S. BANK HOLDING COMPANIES (2012), available at <http://nyfed.org/1jk9VHJ> (last visited June 11, 2014).

¹⁷ MBIA Ins. Corp. v. Countrywide Home Loans, Inc., et al., 936 N.Y.S.2d 513 (N.Y. Sup. Ct. 2012). Readers should be aware that the author was a testifying witness on behalf of MBIA in the MBIA case.

¹⁸ E.g. <http://1.usa.gov/1pjcRfi> (PepsiCo. freeze-out merger agreements offering controlled public subsidiary shareholders choice of stock or cash subject to aggregate limits); see Wachtell, Lipton, Rosen & Katz, *Takeover Law and Practice*, 1-156, 77-81 (Mar. 2014), available at <http://bit.ly/1u4P8wY> (last visited June 11, 2014) (discussing mixed consideration alternatives).

companies.¹⁹ Buyers can have existing businesses – “*strategic*” buyers – or may be newly formed solely to carry out the transaction, typically raising the price of the deal by issuing equity to a “*sponsor*” (such as a private equity fund) and debt to banks or investors in the leveraged loan market, sometimes combined with sales of bonds or preferred stock – “*financial*” buyers. Acquisitions by financial buyers are commonly called “buyouts,” and where newly issued debt is used to generate the currency used in the deal, the buyouts are called “*leveraged buyouts*” or LBOs. Where the seller is also a private equity fund, the deal is commonly referred to as a “*secondary buyout*”; where the seller is a company with other businesses, a buyout of one its divisions or subsidiaries is commonly referred to as a “*divisional buyout*.”

A final observation about deal types: many economically identical (or highly similar) M&A transactions can be accomplished through more than one combination of legal components. One-step mergers are similar to tender offers followed by freeze-outs. A cash bid can achieve much the same effect as a stock-for-stock merger coupled with a buyback of shares. A leveraged buyout is similar to a buyout funded with cash on hand, followed by new borrowings to replace the cash. A purchase of all assets plus target liquidation can produce economically equivalent results as a merger. And so on. This fact can make it hard to regulate M&A transaction effectively through simple, clear rules. Coupled with differences in legal treatment of different forms of M&A transaction, the economic similarity of different transaction forms can also make it hard for conventional doctrinal analysis to rationalize fully, or even to identify adequately the goals served by, every feature of M&A law and regulation.

III. What roles exist for regulation of M&A transactions?

Let us turn to the goals of regulation of M&A transactions. Within the traditional scope of corporate law, three major regulatory goals pertaining to M&A exist: (a) to enhance and clarify authority and control over a corporation as applied to M&A, setting baseline entitlements to participate in related decision-making, (b) to facilitate M&A by overcoming collective action problems and transaction costs, (c) to constrain and improve the outcomes associated with conflicts of interest, and (d) to deter or mitigate looting, asset-stripping and excessive M&A-related leverage. If the owners of a party are dispersed, an additional goal of M&A law is (e) to protect those owners, a goal that sometimes overlaps or extends into the domain of securities regulation and listing standards. As discussed below, a major “mode” or method of regulation of M&A is to impose approval and disclosure requirements – and where owners are dispersed, these requirements have important side effects on M&A process and outcomes, so that another goal of M&A regulatory design is (f) to cope with those side effects. Finally, other bodies of law apply specially to M&A, and while not within

¹⁹ For general discussion of the many ways in which M&A varies across ownership of target companies, see John C. Coates, The Powerful and Pervasive Effects of Ownership on M&A, Olin Center Discussion Paper No. 669 (June 2010), available at papers.ssrn.com/sol3/papers.cfm?abstractid=1544500.

the scope of corporate law and governance as generally understood today, those bodies of law interact with corporate law and governance sufficiently that they must be taken into account as well.

The material in this section is not meant to present a comprehensive list of all possible justifications for regulation of M&A, nor is it meant to justify regulation overall or in any given instance. Rather, the justifications that are commonly offered for (or common rationalizations of) major types of actual regulation (discussed more below) are presented, with only passing reference to costs or unintended consequences of regulation. This choice of presentation reflects not a naïve embrace of the nirvana fallacy. Many efforts to regulate M&A fail for the reason already noted above (i.e., that M&A can sometimes be structured in many different ways, sometimes so as to successfully evade a given law or regulation), and all regulatory efforts impose at least some costs. Instead, the material simply reflects standard arguments for entrenched modes of regulation, which all those who are interested in M&A contend with, whether in designing deals, complying with law or proposing reforms to M&A regulation.

A. Enhancing and clarifying authority, control and baseline entitlements

An important function of corporate law is to establish “default” or baseline entitlements to control over a corporation. Even if no one set of entitlements is best in all settings, a clear baseline economizes on contracting costs. Because M&A transactions are so fundamental and significant, and have potentially dramatic effects on the value of a company (and therefore on common stock), it is natural to set a baseline right for common shareholders to participate in the decision whether to engage in an M&A transaction. This is particularly likely when an M&A transaction involves either (a) a sale or liquidation of a company (as when all of a target’s assets are purchased for cash) or (b) an acquisition in which the buyer issues a significant amount of equity. (If an M&A transaction is structured as a stock purchase, a role for shareholders emerges from contract and property; but if the transaction is structured in other ways, or if statutes provide overrides (as in a merger or squeeze-out), it does not.)

However, because M&A is not a clearly defined category – as discussed above – and bleeds into routine transactions, it is hard to map shareholder participation onto all M&A transactions, without sweeping in many transactions for which shareholder governance would not be efficient as a baseline. (Shareholders can obtain or broaden such governance rights by contract, such as a voting or shareholders agreement.) Dividing M&A into subsets where shareholder governance is usefully required and where it is not, then, is one role for corporate law.

In addition, M&A creates opportunities and incentives for corporate decision-makers (boards, officers, employees) to conflict with *one another* (and with shareholders) over whether, when, and how to engage in such transactions, and for some to pursue transactions

without actual authority. Even if each agent or decision-maker is free of a personal conflict of interest, the dramatic nature of a change in control and ownership, or of a significant and abnormal shock to normal operations, may lead agents to deviate from normal corporate practices. For example, one officer may in good faith pursue a transaction and agree to negotiate exclusively with one potential counterparty, only to have other officers, or the board, disagree with this method of pursuing a transaction and try to stop the deal. An M&A transaction can involve contracts that commit a company to take on operations (perhaps at a subsidiary of a target) that are not subject to adequate controls, and can thus undermine the control authorized corporate decision-makers customarily have over a company or its assets.

Corporate law clarifies who decides, and how, and who will have control and responsibility over the combined company after the deal. Because of M&A's significance, and because corporate actors and third parties alike often have a greater need to rely on the fact of appropriate authorization in an M&A context, corporate law typically imposes explicit or implicit requirements on M&A that differ from those applicable to more ordinary business decisions. For example, when does a corporate officer need to notify or obtain explicit authority from the board to sell a business, or enter into a contract to buy one, or sell a potentially controlling block of stock?²⁰ If shareholder approval is required, what vote is required, and through what mechanism? If not, are disclosures to shareholders required, and if so, when? These aspects of M&A-related laws can be understood as (efficiently) communicating to all concerned a clear set of default procedures for authorization of M&A transactions.

B. To facilitate M&A by overcoming collective action problems and transaction costs

A second goal of M&A law is to facilitate M&A transactions. As noted above, asset purchases can generate extensive transaction costs under background conditions of property and contract law, which can prevent the transfer of control and ownership of business and so reduce social welfare. If a large bank had to obtain consent from each borrower to transfer each of its loans to a buyer, the costs might overwhelm the benefits from the sale, even if the buyer could efficiently combine the target's operations with its own. The structure of corporate law – which permits control and ownership of a collection of assets to be transferred via purchase of stock – facilitates M&A. However, even stock purchases can generate non-trivial transaction costs if ownership is dispersed. While technology (mass communication) has overcome some of these costs, collective action problems may impede M&A under certain circumstances. If an M&A transaction requires individual consents from dispersed shareholders, each shareholder may have an economic incentive to hold out

²⁰ *Jennings v. Pittsburgh Mercantile Co.*, 202 A.2d 51 (Pa. 1964) (officer did not have apparent authority to enter into a sale/leaseback transaction of all of company's real estate); *Grimes v. Alteon, Inc.*, 804 A.2d 256 (Del. 2002) (chief executive officer did not have authority to bind the company to a promise to sell 10 percent of any new stock to an existing shareholder, without board authorization).

in an attempt to remain an equity owner of a business whose value will be enhanced by the bidder after the transaction; if each shareholder has that incentive, then none may sell, preventing value-increasing transactions from occurring.²¹ Law can overcome those incentives by providing mechanisms to force target shareholders to accept a proposed M&A transaction under specified circumstances, as in a merger, scheme of arrangement or squeeze-out.

C. To constrain conflicts of interest

A more controversial set of legal constraints on M&A is designed to constrain or improve the outcomes of conflicts of interest that arise in the M&A context. Such conflicts can take a variety of forms, some obvious, some less so. In a management buyout or MBO, officer-fiduciaries of the target participate as owners of the buyer, and so face a clear conflict.²² In a freeze-out of minority investors by a controlling shareholder or parent company, again, the conflict is clear.²³ A controlling shareholder may cause two controlled subsidiaries to merge, or one to acquire the other, and if one of the subsidiaries is wholly owned while the other is not, the transaction's terms may be designed to favor the wholly owned over the partly owned subsidiary.²⁴ Absent legal protections, management or the control shareholder would be tempted to offer an unfairly low price; investors, anticipating this, would refuse to invest, or would impose a severe discount on the value they would place on the shares. Since investors would not know in advance when such a conflict transaction might occur, the cost of capital would be higher for all firms. In a hypothetical bargain designed to maximize the joint gain to both the conflicted party and investors, the parties would agree to some degree of legal protection, and corporate law can economize on bargaining costs by imposing such protections as a default.²⁵

Other conflicts are less direct but clear and significant. Fiduciaries may propose a spin-off in which they are given the right to buy a controlling stake.²⁶ A fiduciary may sell a public company to an arm's-length buyer but simultaneously engage in negotiations to buy back part of the public company from the buyer.²⁷ A control shareholder who also serves as a

²¹ Michael Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 J. Bus. 345-376 (1980); Sanford J. Grossman and Oliver D. Hart, *Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation*, 11 Bell J. Econ. 42-64 (1980).

²² E.g., *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261 (Del. 1989).

²³ E.g., *In re Cox Communications Inc. Shareholders Litigation*, 879 A.2d 604 (Del. Ch. 2005); *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

²⁴ E.g., *In re Southern Peru Copper Corp. Shareholder Derivative Litigation*, 52 A.3d 761 (Del. Ch. 2011).

²⁵ John C. Coates IV, "Fair Value" as a Default Rule of Corporate Law: Minority Discounts in Conflict Transactions, 147 U. Penn. L. Rev. 1251 (1999).

²⁶ E.g., *Robert M. Bass Group, Inc. v. Edward P. Evans, et al.*, 552 A.2d 1227 (Del. Ch. 1988).

²⁷ E.g., Steven Bertoni, *Carl Icahn Attacks Ebay, Marc Andreessen And Scott Cook In Shareholder Letter*, FORBES (Jan. 24, 2014, 9:04 AM), <http://onforb.es/1dBT8FD> (last visited June 11, 2014); see also *In re El Paso Corp. Shareholder Litigation*, 41 A.3d 432 (Del. Ch. 2012).

fiduciary may divert an opportunity to sell the company as a whole by offering to sell a control block in lieu of the whole-company transaction.²⁸

Still other conflicts are real but may not be as stark. Fiduciaries may favor one bidder over another, not in return for an explicit quid pro quo (e.g., in the form of a payment) but to curry good will in the hope of obtaining post-deal employment, or perhaps out of malice towards a bidder or gratitude for some past favor. Fiduciaries may prefer one set of transaction-related agents (investment bankers, lawyers, lenders) for the same kinds of reasons. Those agents may have incentives distorted if they own equity in a party with interests opposed to their client.²⁹ Fiduciaries may seek to sell their company “too early” or “too cheaply” to trigger “golden parachutes” or vesting under option plans or retirement plans, or in return for benefits from the buyer.³⁰ Fiduciaries of a target may have business or social ties to a buyer.³¹

Conflicts can exist at the shareholder level (between control and minority shareholders), between shareholders and the board, among board members, between the board and officers and between officers and the company. The range of potential conflicts created by an M&A transaction is enormous – and the opportunity to hide payoffs or benefits from the transactions is generally larger than is true in the ordinary course of corporate decision-making. In all of these circumstances, corporate law and governance may be able to improve on outcomes for shareholders by constraining the process or nature of the transaction.

D. To protect dispersed owners

Corporate law (and closely related securities regulations) can also protect the interests of dispersed owners in the M&A context. Where an M&A transaction requires shareholder approval or consent, law can usefully specify what information and process needs to be followed to obtain that approval (particularly how long shareholders must be given the consider whether to approve). The information required and process to be followed may differ if the shareholders are dispersed, and so likely to be less informed, to be able to protect their own interests, or to act quickly than a small number of owners. Because bids

²⁸ E.g., *Thorpe v. CERBCO, Inc.*, 676 A.2d 436 (Del. 1996).

²⁹ E.g., *In re El Paso Corp. Shareholder Litigation*, 41 A.3d 432 (Del. Ch. 2012); see also John C. Coates, Clayton Rose, and David Lane, *El Paso’s Sale to Kinder Morgan*, HLS 13-08 (July 25, 2012), *available at* casestudies.law.harvard.edu/el-pasos-sale-to-kinder-morgan (last visited June 11, 2014).

³⁰ E.g., *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 2012); John C. Coates, Clayton Rose, and David Lane, *Barclays Capital and the Sale of Del Monte Foods*, HLS 13-07 (July 27, 2012), *available at* casestudies.law.harvard.edu/barclays-capital-and-the-sale-of-del-monte-foods/ (last visited June 11, 2014).

³¹ E.g., *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156 (Del. 1995) (holding merger satisfied fairness standard where majority of board of directors was disinterested and two directors who were interested disclosed); see also *Orman v. Cullman*, 794 A.2d 5 (Del. Ch. 2002) (independent directors not found “beholden” conflicted fiduciary simply because of long-standing business relations or co-service as directors).

can be structured to have a coercive effect on dispersed shareholders – the reverse of the collective action problem discussed above – dispersed shareholders may need protection even when they are informed, active and sophisticated.³² Even where a transaction does not require (as a baseline entitlement) shareholder approval, dispersed shareholders may still need information to decide whether they should use other legal rights (e.g., through normal voting rights to elect directors, or the right to sue in response to conflicts of interest). Without specific approval rights, moreover, shareholders may suffer the effects of M&A before they can mobilize to protect their interests with normal voting rights or other governance mechanisms. This risk that seems most acute for bidders, whose value may be destroyed by poorly conceived acquisitions, than for targets, which generally attract bids at prices over market prices.

E. To deter or mitigate looting, asset-stripping and excessive M&A-related leverage

Particular risks towards which M&A law may be directed include the risk of looting, asset-stripping or excessive leverage from debt-financed M&A. “*Looting*” here means theft or clear violation of fiduciary duties or other legal obligations (arising under contract, tort, property or other bodies of law) resulting in a transfers of value from a company to a person in control of the company. Looting harms not just shareholders, but also creditors, employees, and others who depend on the continued functioning of the business. Looting is by definition already made illegal by non-M&A law. But because M&A results in a change of control, it can increase the risk of looting, and M&A-related duties may enhance the effectiveness of such laws, such as the imposition of a duty of care on decision-makers who are selling not to sell to a person with a reputation as a looter.

A similar potential result of M&A is asset-stripping. “*Asset stripping*” is the transfer out of a business (often via M&A) of value (as in a transaction at an unfair price), or of revenue- or earnings-generating assets of a company. Even if those transfers are at a fair price they may insure that certain creditors will not be paid, while others (and perhaps shareholders, too) obtain value from the transaction or the company, in violation of normal payment priorities.³³ The result is that the company is left insolvent (immediately or over time, as contingent liabilities are realized), and with non-operating assets that are incapable of generating growth or future revenues or earnings. Asset stripping includes conduct that verges on or in fact may constitute fraud in contexts where complexities associated with valuation and proof of intent³⁴ may make fraud claims grounded in tort or other doctrines

³² E.g., Lucian Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. Chi. L. Rev. 973 (2002).

³³ Cf., e.g., MBIA Ins. Corp. supra note 17 (refusing to grant motion for summary judgment on a claim alleging de facto merger under New York law based on same transaction, also finding no meaningful conflict between Delaware and New York law on question) with *MBIA Insurance Corp. v. Countrywide Financial Corp.*, N.Y. Supr. Ct. (Apr. 29, 2013); *In re Countrywide Financial Corp. Securities Litigation*, 588 F.Supp.2d 1132 (C.D. Cal. 2008) (granting motion for summary judgment against claim alleging de facto merger under Delaware law).

³⁴ PLSRA § 21D(b)(2); FRCP Rule 9(b).

difficult or impossible. Asset stripping can also result in what would (in an insolvency or bankruptcy proceeding) be treated as preferential payments, and sometimes also involves transactions implicating conflicts of interest (where for example insiders or control persons are the recipients or beneficiaries of the transfers).

Where a target has only one shareholder after an M&A transaction, as when a private company is the buyer, the result of asset stripping is to harm creditors. Where a target continues to have dispersed owners after control has passed, it may also harm shareholders. Where value is itself taken, the harm of asset stripping is clear. Where revenue- or earnings-generating potential is taken (but value is not clearly reduced), the harm is not direct, but flows from the reduction (or, in the limit, elimination) of the possibility that a target business nearing insolvency may recover, by virtue of having an uncertain future expected value reduced to a certain or near-certain insolvency or by virtue of having residual assets distributed in a non-pro rata fashion (the anticipation of which can reduce the value of all firms potentially subject to this technique).

As with looting, other laws of general application – rules about dividends (actual or constructive), fraudulent conveyance, theft, fiduciary duties, fraud or preferential payments – may constrain asset stripping. However, it is a common risk for corporate claimants in the M&A context, and can be amplified by M&A, due to the transfer of control and the ability of an M&A participant to camouflage asset stripping with the pretext of ordinary post-deal consolidation or restructuring. The difficulties of proof and enforcement may justify tighter legal constraints in the M&A context, absent which M&A may be induced by the possibility of successful asset stripping.

A final if less extreme example – and therefore one that generates more public policy debate over whether it should be regulated – is the incurrence of excessive debt as a result of an M&A transaction. Even if assets are not removed, M&A that is funded by new debt, or for which debt is part of the deal currency, the target (or bidder) may be left with more debt than it can repay. This is most likely to be true if the surviving company already had significant debt in place prior to the M&A transaction, such that the related creditors were not (at the time of the transaction) able to price the risk of insolvency arising from the increased debt.

Contract creditors can (in theory³⁵) demand covenants to prevent, or a price that reflects, the risk of M&A-related increases in debt, as well as asset stripping. Tort creditors cannot do so, however, nor (due to transaction costs) can employees, many kinds of contract counterparties (e.g., with warranty claims) or other third parties that may be affected by a resulting insolvency. Laws aimed at preventing sudden and excessive M&A-related increases

³⁵ David Musto and Jillian Popadak, *The Pricing of Bond Covenants*, Working Paper (2014) document that change-of-control covenants re-emerged in the buyout wave of the 2000s, but only after it was too late to protect lenders or other creditors affected by those buyouts.

in debt may protect these parties. Even contract creditors (such as banks) may lack appropriate incentives to prevent excessive risk, due to moral hazard or internal agency problems, and tax laws may induce levels of debt that are excessive relative to what would otherwise be socially optimal. Transaction costs may also be reduced if law sets baseline restrictions on excessive debt for the benefit of contract creditors (who then do not need to contract for those restrictions). Regulatory strategies aimed primarily to prevent systemic risk or tax-induced speculative excess may include restrictions on debt-financed M&A.

F. To cope with the effects of other regulations

All of the laws justified by the foregoing rules are likely to produce unintended and sometimes pernicious consequences, given the difficulties of enforcement and achieving precise, targeted goals through general laws. For example, a rule facilitating M&A by allowing shareholders to be forced to accept transaction via statutory merger or squeeze-out mechanism may make inefficient transactions easier for a conflicted fiduciary to pursue. Disclosure obligations may chill bids. Constraints on conflicts of interest may make efficient transactions less likely. Shareholder approval requirements may create opportunities for third parties to compete for a target during the shareholder approval period. Private actors may attempt to respond to these consequences in ways that either undermine the purpose of the laws or create additional problems. For example, private contract can mitigate the risk of post-announcement bid competition (e.g. through break fees), which thereby undermines the shareholder approval or consent requirement that creates the risk of competition. Fiduciary obligations to obtain the best reasonably available price may lead targets to insist upon “no-shop” or “go-shop” clauses in M&A contracts.³⁶

Another, second-order role for corporate law, then, is to mitigate unintended consequences and private responses to first-order corporate laws. Specialized courts, regulatory agencies or other means to address evasions and enforce laws governing M&A can be understood in this way, as can a variety of laws and regulations focused on the process of approving an M&A transaction as well as a variety of exemptions from otherwise applicable M&A-related requirements. First-order structural laws are (almost by definition) important, so much so that they are taken for granted by practitioners. For instance, it would not occur to most M&A lawyers (or judges, for that matter) to ask whether shareholders should have any role in approving the liquidation of their investment in an M&A transaction. The nuances of second-order laws that mitigate the effects of first-order laws, by contrast, can be of first-order practical importance, as they are more likely to be modified by lawmakers (such as judges) and be affected by choices of transaction participants and their lawyers.

³⁶ Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, 63 *Bus. Law.* 739 (2008); *In re The Topps Co. 12 Shareholders Litig.*, 926 A.2d 58 (Del. Ch. 2007) (permitting a board to undertake a post-signing 'go shop' period rather than a full auction process).

G. Antitrust, industry regulation, foreign ownership, and tax

Finally, M&A implicates a variety of third party or social interests. M&A is a fast way to achieve monopoly power, and is typically regulated separately under general antitrust laws to prevent or remediate such power.³⁷ Industry-based regulations (e.g., banking, airlines, telecommunications, utilities) are often aimed at preserving or stabilizing firms that produce public goods (systems of payment, communication, transportation, or energy production) that are vital to society and the economy. As one means to prevent private interference with those systems often include rules specifying who may obtain control over companies in those industries, and M&A is often regulated specially in those industries.³⁸ Foreign ownership of domestic business can raise political concerns that range from the cross-culturally intuitive to the less so – e.g., in the defense, yoghurt or tea industries – and so cross-border M&A is often regulated specially.³⁹ M&A can be a way for owners to liquidate or realize cash from profits built up in a business, and in most income tax regimes, tax is

³⁷ E.g., Hart-Scott-Rodino Antitrust Improvements Act of 1976 § 5 (prohibiting mergers and acquisitions that constitute “unfair . . . competition”); Clayton Act of 1914 § 7 (prohibiting the acquisition of stock or assets where “the effect of such acquisition may be substantially to lessen competition, or to tend to create monopoly”); Federal Trade Commission Act of 1914 § 5 (declaring “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce . . . unlawful”).

³⁸ See, e.g., Bank Holding Company Act of 1956 § 1972; Airline Deregulation Act of 1978; WILLIAM GILLESPIE AND OLIVER M. RICHARD, ECONOMICS ANALYSIS GROUP, U.S. DEPT. OF JUSTICE, ANTITRUST IMMUNITY AND INTERNATIONAL AIRLINE ALLIANCES (“Recent decisions by the U.S. Department of Transportation . . . to grant immunity from the U.S. antitrust laws to large groups of airlines in alliances relating to international air transportation represent a significant development.”), available at <http://1.usa.gov/1lo9QXT> (last visited June 11, 2014); Telecommunications Act of 1996; Federal Power Act of 1920.

³⁹ For the US, see the Defense Production Act of 1950 § 721, as amended by the Foreign Investment and National Security Act of 2007 (known as the *Exon-Florio Amendment*) and implemented by Executive Order 11858 and regulations at 31 C.F.R. Part 800, authorizes the Committee on Foreign Investment in the United States (CFIUS) to inspect M&A deals that may produce foreign control of a U.S. entity. Roughly 100 deals require filings under Exon-Florio in the US per year, and only a small number go through a second-stage review, and even smaller number have been blocked. For one of the few, see Sara Forden, *Obama Bars Chinese-Owned Company from Building Wind-Farm*, BUSINESSWEEK.COM (Sep. 28, 2012 11:47 PM), <http://bloom.bg/1knObKB> (last visited June 11, 2014). For yogurt in France, see *France Flouts the Pepsi Challenge*, THE TELEGRAPH (July 24, 2005 12:01 AM) (French Labour Minister, among other officials, pledged to do “all we can” to defeat PepsiCo bid for Danone.), available at <http://bit.ly/1knOoNT> (last visited June 11, 2014). For tea in China, see US Government Accountability Office, *Foreign Investment: Laws and Policies Regulating Foreign Investment in 10 Countries*, GAO-08320 (Feb. 2008) at 44 (noting that tea production is protected industry in China). Foreign acquisitions in the UK are not governed by a single legislative framework, the UK is generally perceived as open to foreign investment, and the EU’s “single market” rules have encouraged openness generally in Europe. The UK government nonetheless has authority block deals that affect the national interest, water companies, or media companies, if they are against the “public interest,” as well as in “important” manufacturing concerns, and there have been six interventions since 2003 on national security grounds, and one on “public interest” grounds. As common in the EU, the UK owns a “golden share” blocking a transfer of control over key companies, such as Rolls-Royce (due to its nuclear business) and BAE systems (defense). *Id.* at 99-100. Although India has liberalized significantly in the past 20 years, India remains stricter than the US or the UK in regulating foreign M&A of domestic businesses across more industries. *Id.* at 65-72.

typically linked to such realizations, and more generally, tax systems are often linked to transactions, including M&A.⁴⁰

While M&A-related laws emerging from antitrust, industry regulation, foreign ownership and tax are not formally part of corporate law, and a detailed review is beyond the scope of this chapter (and book), they have important implications for the ways corporate law regulates M&A. Such laws can create incentives for certain kinds of M&A transactions, versus others; or impose delays or notice requirements that collaterally inform the public, or relevant corporate decision-makers, or potential competing bidders; or constrain how ownership and control can be allocated after a transaction. For those reasons, M&A practitioners tend to be highly aware of these related bodies of law, and corporate law is sometimes modified in response to their effects.

IV. What modes exist for regulation of M&A transactions?

In this section, the analysis moves from potential purposes for law to actual law. The material is organized around mode of regulation, with some serving multiple purposes. The presentation is not meant to be exhaustive, but illustrative, with examples from the US, the UK and India.

A. Facilitating M&A

a. Collective action: mergers and schemes of arrangement

One purpose of M&A law is to facilitate M&A. One way the law does this is to assist decision-makers in overcoming collective action problems. One method to do this is to permit an M&A transaction to be “forced” upon shareholders, even without their consent, provided certain procedural conditions are satisfied. One example – our first mode of M&A regulation – is the statutory merger, which effectively allows a share of common stock to be converted into some other thing (or even, in the limit, nothing⁴¹), in connection with the legal combination of the issuing corporation with some other corporation, provided the statutorily specified steps for a merger are completed. Every US state provides for a

⁴⁰ See Internal Revenue Code § 368 for conditions for tax-free treatment. In general terms, US law requires recognition of capital gain, and taxes it, upon the occurrence of many M&A deals, unless they qualify for “tax-free” (really, tax-deferred) treatment, and even then, imposes a tax on any consideration other than stock received in the transaction. In the UK, cash consideration will typically trigger tax, but tax may be deferred even upon the receipt of qualifying notes or debt from the buyer (as well as stock); stock transfer taxes may arise in bids structured as stock purchases, however. Laurence Levy, Jeremy Kutner and Simon J. Little, *Public Mergers and Acquisitions in the UK (England and Wales): Overview*, Practical Law (May 1, 2013), available at <http://us.practicallaw.com/8-502-2187#a688792> (last visited June 11, 2014).

⁴¹ See *Odyssey Partners, L.P. v. Fleming Companies, Inc.*, 735 A.2d 386 (Del. Ch. 1999) (finding that the net asset value of company was zero or less, as a partial basis for holding that conflict of interest transaction involving majority shareholder and creditor of company was not entirely unfair); see also *S. Muoio & Co. LLC v. Hallmark Entertainment*, 2011 WL 863007 (Del. Ch. Mar. 9, 2011); *In re Vision Hardware Group, Inc.*, 669 A.2d 671 (Del. Ch. 1995), *aff'd sub nom Young v. Vision Hardware Group, Inc.*, 676 A.2d 909 (Del. 1996); *In re Hanover Direct, Inc. Shareholders Litigation*, 2010 WL 3959399 (Del. Ch. Sep. 24, 2010).

merger,⁴² and compulsory share exchanges, with much the same result, are also permitted by statute in a majority of US states.⁴³ Typically, a statute requires one corporation to be designated as the “surviving” or “continuing” corporation, which by operation of law succeeds to all assets and liabilities of the two combining companies. That choice is generally independent of whether one or both combining companies’ shareholders continue as shareholders.

As noted above, one company that is formally “combining” in a US merger may be a newly created shell corporation, wholly owned by a true party-in-interest (e.g., a parent/buyer), solely for the purpose of merging with another (e.g., a target). In such a triangular relationship, the statutory requirements of the merger apply to the shell and the target, the formally combining entities, rather than to the parent/buyer and the target, as might occur in a less formalistic legal treatment. The “currency” used in a merger – i.e., whatever the combining corporations’ stock is to be converted into – need not even be owned as property by one of the combining companies, so long as the parties to the related agreement and plan of merger include a company that does own that currency. Another result of this combination of formalism and flexibility is that in the US the merger can also be used in post- or extra-M&A reorganizations, for example, to shuffle the hierarchy of related corporations, or to effect a recapitalization or reorganization, or to interpose a new holding company or intermediate holding company between an operating company and its shareholders or parent and company.

In the UK, the primary example is the scheme of arrangement,⁴⁴ which provides for mergers as well as a broader array of restructuring or combination transactions. Schemes of arrangement have their origin in stand-alone recapitalizations or reorganizations by financially distressed companies,⁴⁵ and are not limited to arrangements in which two or more companies be combined. But they can be, and UK law now expressly contemplates them to be used to coordinate shareholders in the approval of M&A transactions, effectively imposing the results on dissenting (or inattentive) shareholders.⁴⁶ In both jurisdictions, then, a statutory device originally aimed at different original goals (combinations, recapitalizations) has been repurposed to the other goal, and both goals are now commonly pursued together and separately through that device.

India, too, permits schemes of arrangement, but they play a less important role than in the UK, because among Indian companies dispersed *control* is rare, even in listed companies with

⁴² E.g., DGCL §251.

⁴³ E.g., NYBCL §913.

⁴⁴ E.g., UK Companies Act 2006, Parts 26 - 28.

⁴⁵ John Tribe, *Companies Act Schemes of Arrangement and Rescue: the Lost Cousin of Restructuring Practice*, J. Int’l Banking & Fin. Law (2009).

⁴⁶ Jennifer Payne, *Schemes of Arrangement, Takeovers and Minority Shareholder Protection*, U. Oxford Legal Research Paper Series No. 42/2010 (May 2010).

dispersed *ownership*.⁴⁷ A related point is that corporate governance generally is less protective of minority investors in India (although it has been improving in that regard⁴⁸), with the result that control shareholders may find it more useful to preserve minority investment even after an M&A transaction than in the US or the UK, where it is difficult for control shareholders to exploit their control positions at the expense of minority investors.

b. Call rights: squeeze-outs

A second way that law can facilitate M&A is to provide corporate decision-makers with “calls” on stock. That is, provided a designated process is followed, a corporation can force its shareholders (typically less than a majority) to accept cash in lieu of their shares. By allowing controllers to “squeeze out” minority shareholders in this way, the law creates a means by which a bidder can obtain 100% ownership following a control acquisition, while avoiding the free-riding problem noted above. In the US, squeeze-outs are typically achieved via merger – either under a special statutory provision designed for this purpose,⁴⁹ or under the more general-purpose merger statute described above⁵⁰; occasionally, they are achieved via “*reverse stock split*,” in which a corporation via charter amendment converts all shares into a smaller fraction (e.g., three for one) and provides cash in lieu of fractional shares.⁵¹ In the UK, squeeze-outs are achieved pursuant to a provision of the Takeover Code, now embodied in the Companies Act 2006, which expressly permits a more straightforward conversion of minority shares into cash (“compulsory acquisitions”) following a bid (and also provides shareholders equivalent “put” rights, to force such a conversion).

B. Constraining M&A

a. Notice and disclosure

The least restrictive mode of regulation that is designed to constrain M&A requires special notices and disclosure. Advance notice to a board of directors of the parties is typically required for agents to have authority to engage in significant transactions, although norms vary on how far in advance, how frequently, and in how much detail a board should be

⁴⁷ S.J. Mathew, *Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities*, 3 *Colum. Bus. L. Rev.* 800, 833 (2007) (noting that as of 12/31/06 average ownership percentage of BSE 500 companies was 49.55%); V. S. Khanna and S. J. Mathew, *The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidence*, U. Mich. Empirical Legal Studies Center Working Paper NO. 10-025, 22 *Nat'l L. Sch. Of India Rev.* 35 (2010), at 53 (majority of independent directors surveyed understood their role to be primarily advisors to control shareholders, known as “promoters” in India).

⁴⁸ B.S. Black and V.S. Khanna, *Corporate Governance Reforms Increase Firms' Market Values*, Working Paper (Oct. 2007), available at http://ssrn.com/abstract_id=914440 (last visited June 15, 2014).

⁴⁹ See DGCL §§251(g) and 253.

⁵⁰ See DGCL §251(c).

⁵¹ E.g., See Maryland Code of Pub. Gen. L. § 2-309; see also *Milton Applebaum v. Avaya, Inc.*, 805 A.2d 209 (Del. Ch. 2002) (holding proposed stock split complies with Delaware statute).

informed prior to formal board authorization. In conflict of interest transactions, at least, the safest practice would include advance notice at the earliest point that a conflicted fiduciary becomes aware of a transaction that has a material chance of occurring.⁵² It may be tempting for officers facing a conflict to treat notice to a single board member, such as a chairman or lead director, as the equivalent, but individual directors do not on their own have (as a default matter) authority to act on behalf of a corporation, and if the chairman or lead director chooses to not pass the information on to the full board, the conflicted officer may find the transaction in legal jeopardy.⁵³

Bidders or targets are sometimes also required to give advance notice to be given to shareholders, although how and when this is accomplished varies with jurisdiction and transaction structure.⁵⁴ In the US, a company's board may bind it to a merger agreement without advance notice to shareholders, but the agreement must thereafter be noticed to and approved by shareholders,⁵⁵ and for public companies, entry into any "material" agreement (including an M&A agreement) requires disclosure within four business days.⁵⁶ In the UK, listed companies must give notice to shareholders "as soon as possible" after terms are agreed for large transaction, defined to include those involving more than 5% of gross assets, profits, consideration or gross capital.⁵⁷

⁵² An interesting and undeveloped question may arise if the target is or may become insolvent before or as a result of the transaction, in which case even a sole shareholder may face a conflict in pursuing or designing a transaction, in which case notice to creditors may become an effective requirement as a result of duties owed by that shareholder (or a board) of the insolvent company. E.g., *In re Central Illinois Energy Co-op*, 2012 WL 3638027 (Bank. C.D. Ill. 2012); *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007) (directors owe duties to corporation and shareholders, but creditors may protect interest through derivative action when corporation is in "zone of insolvency"); *Prod. Res. Gp., L.L.C. v. NCT Gp., Inc.*, 863 A.2d 772, 776 (Del.Ch.2004) (same).

⁵³ E.g., *Southeastern Pennsylvania Transportation Authority v. Rubin et al.*, 2011 WL 1709105 (Apr. 29, 2011).

⁵⁴ If a shareholder approval is required, discussed below, advance notice of the meeting will be required both under state corporate law and under stock exchange rules. E.g., DGCL 213 (setting of record date for meeting) and 222 (notice of meetings); NYSE Rules § 4; Amex Rules Part 7; NASDAQ Rule 5620.

⁵⁵ DCGL 251.

⁵⁶ SEC Form 8-K. "Material" for this purpose is not defined in a specific way, but would clearly include any merger agreement for a target, and the instructions to the SEC's form indicates that material agreements include those for property, plant and equipment if the consideration is 15% or more of a company's fixed assets. Filings are also required for any material amendment or termination of a material agreement, for the completion of the acquisition or sale of significant assets (equal to 10% or more of the company's assets), for private sales of more than 1% of the company's equity securities, for material changes in rights of security holders, for changes of control, and for changes to the company's charter or bylaws. In addition, SEC Regulation S-X requires pro forma and audited target financial statements to be filed on the bidder's Form 8-K if the target's assets or income exceed 20% of the bidder's assets or income.

⁵⁷ UK Listing Authority Listing Rule 10.4. If the transaction exceeds 25% of those measures, shareholder approval must also be obtained, as discussed below.

Bids or tender offers for stock of public companies can only be completed if target shareholders are given advance notice and time to consider the offer.⁵⁸ If a buyer is using non-cash deal currency and the target is held by more than a small number of investors, US law will treat an M&A transaction as if it were a securities offering to the target shareholders and require extensive disclosures in advance of any shareholder commitment to the deal.⁵⁹

Heightened disclosure requirements apply to a major class of conflict-of-interest transactions – those in which insiders (“affiliates”) or controlling shareholders buy out the public shareholders and cause the target to “go private.”⁶⁰ Advance notice is also typically required to be given to antitrust regulators for any significant transaction.⁶¹ Transactions that are premised on the expectation of layoffs may trigger advance notice requirements benefiting employees.⁶²

b. Special approvals

M&A transactions are typically subject to approvals of parties. In the US, these requirements mainly arise on the target side, and effectively arise on the buyer’s side only when stock is being used as deal currency. Where common stock is used as deal currency and more than 20% of the buyer’s pre-deal outstanding shares are to be issued, US stock exchange rules require shareholder approval from the buyer.⁶³ In deals involving stock as deal currency in the UK, preemptive rights provide existing buyer shareholders with some ability to protect their interests, not by voting on the deal, but by investing on the same

⁵⁸ In the US, see Securities and Exchange Act § 14(d)-(f); SEC Regulations 14D and 14E; Schedule T-O (form used for tender offers); in the UK, see Takeover Code, Rule 24.

⁵⁹ SEC Rule 145; Securities Act of 1933 and Form S-4 (form used for M&A-related offerings).

⁶⁰ SEC Rule 13e-3. SEC Form 8-K also requires disclosure of contracts with directors or officers, subject to specific exceptions, and SEC Regulation 14A Item 404 separately requires disclosure of specified “related party” transactions involving more than \$60,000 or 5% of consolidated gross revenues in the issuer’s next proxy statement, including any deal-related proxy statement, such as will be required to obtain any required shareholder approval.

⁶¹ In the US, the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (15 U.S.C. § 18a), and related rules require both buyer and target to file, and a buyer to obtain clearance, prior to the acquisition of more than ~\$70 million in value of equity securities (the amount is adjusted annually in line with growth in the economy). Mergers and most acquisitions of assets constituting a business also require such filings. In Europe, including the UK, a similar mandatory notification and clearance requirement exists under Regulation (EC) 139/2004 (“Merger Regulation”) for deals involving parties with global revenues over EUR5 billion and EU-wide revenues over EUR250 million, or if global revenues are over EUR2.5 billion, EU-wide revenues exceed EUR100 million for two or more parties, combined turnover in each of three EU-member states exceeds EUR100 million, and turnover in each of those member state by at least two of the parties exceeds EUR25 million. In addition, a deal involving a UK company may also entail a formally voluntary but practically desirable filing and clearance from the newly created Competition and Markets Authority if UK revenues are over £70 million or the deal will create or enhance a 25% share of the supply of goods or services in the UK.

⁶² In the US, e.g., Workers Adjustment and Retraining Notification (WARN) Act, 12 USC §§ 2101-2109.

⁶³ NYSE Rule 312.03(c); see also Amex Rule 712; NASDAQ Rule 5635. Here, unlike US state corporate law, the stock exchange rules are less formalistic, and are triggered for the parent/buyer issuing the stock, even if the parent/buyer is not a formal party to the merger, and even if the issuance is achieved in a series of steps.

economic terms as are being offered to target shareholders.⁶⁴ In addition, in the UK, listed companies must obtain shareholder approval for any “substantial acquisition,” that is, one involving a target with more than 25% of a bidder’s gross assets, profits, gross capital or market capitalization.⁶⁵ No equivalent general requirement for bidder shareholder approval exists in the US.

Where the structure is a purchase of shares, property and contract law effectively require approval of target shareholders, subject to the deal-facilitating laws summarized above. Where the structure is a purchase of assets, the law augments rules of basic corporate governance by requiring special board and shareholder approvals for the target. But because most businesses conduct asset purchases in the ordinary course of business, the dividing line between those that do and those that do not require special votes is either arbitrary or uncertain. In Delaware, the trigger for shareholder approval is the sale of “substantially all” a target’s assets, with all of the vagueness such a standard implies.⁶⁶

In the US, the law imposes special approval requirements for mergers. In Delaware, for example, mergers must generally be approved by both combining companies’ boards of directors and shareholders, in each case by majority vote.⁶⁷ As noted above, triangular mergers effectively eliminate these requirements for bidders, but not for targets.⁶⁸ In the UK, schemes of arrangement are subject to even higher requirements, by both 75% in value and 50% of the number of each class of “members” (i.e., shareholders), and by a court, following receipt of an independent valuation report.⁶⁹ (However, court approval appears to be a pure formality in the UK, if shareholder approval and a reputable expert report are obtained.⁷⁰) In the US, a few states also offer a court-approved transaction path; California’s is occasionally used because it can reduce the regulatory burdens of federal securities

⁶⁴ UK Companies Act 2006, sections 561 – 577.

⁶⁵ UK Listing Authority, Listing Rule 10.1. For an empirical analysis suggesting that this requirement improves outcomes for bidders in the UK, see Marco Becht, Andrea Polo and Stefano Rossi, Does Mandatory Shareholder Voting Prevent Bad Acquisitions?, Working Paper (May 2014), *available at* <http://ssrn.com/abstract=2443792> (last visited June 13, 2014).

⁶⁶ Hollinger Int’l, Inc. v. Black, 844 A.2d 1022 (Del. Ch. 2004), *aff’d* 872 A.2d 559 (Del. 2005).

⁶⁷ This is generally true even if the merger is essentially immaterial for the buyer. The formal requirement of board approval applies, for example, if the cash to be issued to target shareholders is a tiny amount relative to the buyer/parent’s assets. Where a triangular structure is used, the approvals under US state corporate law are generally applied formalistically to the combining companies, and not to the parent/buyer. Hence, the approvals for the shell corporation involved are *pro forma*, since subsidiary directors are typically officers, and an officer can also approve the merger on behalf of the parent company as sole shareholder of the subsidiary. A board’s approval is only required at one point in time, and does not need to continue throughout the M&A process: under DGCL § 146, a merger may proceed to stockholder vote even if a board has changed its recommendation on how to vote.

⁶⁸ See Ehud Kamar, Does Shareholder Voting on Acquisitions Matter?, 64 Am. L. & Econ. Rev. 64 (2006).

⁶⁹ UK Companies Act 2006, section 904 – 918.

⁷⁰ Payne, *supra* note 46.

regulation due to an exemption for court-approved stock issues.⁷¹ Requiring shareholder approval by the remaining minority of target shareholders following a bid would only exacerbate the collective action problem described above. Hence, no such approval is required in the case of post-bid squeeze-outs, or else the law permits the controlling shareholder to effectively force through the merger over the objections of a minority shareholder.

Where M&A transactions involve a conflict of interest, they are typically governed by special approval requirements, either formally or through judicial incentives. In the UK, the Companies Act requires shareholder (“member” in UK parlance) approval of “substantial property transactions” involving directors and connected persons, which would cover deals structured as asset purchases.⁷² In Delaware, management buyouts structured as a merger are not formally subject to any different statutory requirements than any other M&A transaction, but because they present conflicts of interest, they face heightened judicial scrutiny unless subject to approval by a special committee of independent directors,⁷³ and failure to obtain such an approval will itself be a negative factor in the court’s assessment. One might think that court incentives of this sort might not have a strong effect for public companies, because dispersed shareholders would not use them, due to collective action problems, but the derivative lawsuit mechanism in the US enables any shareholder to sue on behalf of all, and nearly all large transactions – particularly those involving conflicts of interest – generate such lawsuits.⁷⁴

In addition to board and shareholder approvals, M&A transactions are often subject to other approvals. Regulators (antitrust, industry-focused, or national security-focused) must approve (or be given an opportunity to object to) significant M&A transactions, subject to court review. Contracts (e.g., bond indentures, loan agreements) may also require third-party consents, typically in circumstances where a change of control could reasonably be expected to increase or change the risks or value of the deal participants’ performance. Such consents may effectively be “bought out” by M&A participants, however, either through explicit redemption or prepayment rights, or through renegotiation of contract terms. Similarly, preferred stock holders typically have approval rights unless the buyer effectively “rolls over” the preferred and preserves its dividend and other rights and powers. If a buyer uses a triangular deal structure, typically the preferred stock will be “rolled over” at the subsidiary

⁷¹ Cal. Corp. Code § 25142; Securities Act of 1933 § 3(a)(9).

⁷² UK Companies Act 2006, Section 190.

⁷³ *Barkan v. Amsted Indus., Inc.* 567 A.2d 1279 (Del. 1989); see M&F Global, *supra* note 21.

⁷⁴ Robert M. Daines and Olga Koumrian, *Recent Developments in Shareholder Litigation Involving Mergers and Acquisitions* (Cornerstone Research, Mar. 2012), available at <http://bit.ly/1yads5t> (last visited June 9, 2014); Steven M. Davidoff, *Corporate Takeover? In 2013, a Lawsuit Almost Always Followed*, N.Y. TIMES (DEALBOOK) (Jan. 12, 2014 12:20 PM), available at <http://nyti.ms/1t6lkg> (last visited June 15, 2014).

level, which may be undesirable for the buyer, in which case the buyer may create incentives for preferred holders to exchange their stock for buyer (parent) company equivalents.⁷⁵

Where a class of preferred (or special class of common stock) has separate approval rights, an M&A deal can be “held hostage” by holders of that class, who make seek more value to flow to them to induce them to permit the transaction to be completed. This risk is most acute if the stock is neither common nor participating preferred (and so would not normally share directly in the benefits of the deal to the combining companies, other than through risk reduction), and if the class is either held by a small number of investors, or may be purchased on the market (as when the preferred is listed on an exchange), in which case hedge funds or other active investors may buy up the stock precisely to hold out against the deal.

c. Augmented fiduciary duties and other legal obligations

As with all corporate decisions, M&A transactions must be approved by corporate decision-makers who are subject to fiduciary duties of care and loyalty, but in the US, M&A transactions are generally subject to heightened judicial (as well as public) scrutiny, whether or not pursuant to formally distinct doctrinal treatment.⁷⁶ It is no accident that the few instances in which US courts have held directors personally liable for breaching their duty of care have been in the context of M&A transactions.⁷⁷ Conventional wisdom among US practitioners that a sale of a company should include at least two board meetings, at least one of which is lengthy; that a publicly held target company’s board should obtain a fairness opinion from an investment bank in order to become reasonably informed about the relative value of the deal; that approval should be preceded by advance notice, review of deal documents or summaries, comparison of options, and preferably some process designed to insure that the deal represents the best reasonably obtainable value. Fairness opinions so obtained are themselves subject to judicial review for the adequacy of the underlying analyses, under both state law and federal securities law.⁷⁸

⁷⁵ See, e.g., *Kirschner Brothers Oil, Inc. v. Natomas Co.*, 185 Cal. App. 3d 784 (1986).

⁷⁶ Directors and officers of UK companies are also subject to fiduciary duties, see generally *Gower and Davies Principles of Modern Company Law* (Paul Davies and Sarah Worthington eds, 9th ed., Sweet & Maxwell 2012), but it is significantly more difficult for dispersed shareholders to bring lawsuits to enforce such duties in the UK in a cost-effective manner, so these duties are less constraining and less significant to M&A practice than in the US. See generally John C. Coates et al., Program on the Legal Profession, *The Legal Profession of the United Kingdom*, available at <http://bit.ly/1pJ0Ld0> (last visited June 11, 2014) (contrasting US and UK legal systems, including availability of contingent fees, attorneys’ fees, discovery, and representative actions).

⁷⁷ *Supra* note 28; see Bernard Black, Brian Cheffins, Michael Klausner, *Outside Director Liability*, 58 *Stan. L. Rev.* 1055 (2006).

⁷⁸ For US state law, see, e.g., *In re Toys “R” Us, Inc. Shareholder Litigation*, 877 A.2d 975 (Del. Ch. 2005); *In re Rural Metro Corp. Stockholders Litigation*, 88 A.3d 54 (2013); for US federal securities law, see [Herskowitz v. Nutri/System, Inc.](#), 857 F.2d 179 (3d Cir.1988), *cert denied*, 489 U.S. 1054, 109 S.Ct. 1315, 103 L.Ed.2d 584 (1989) (investment bank could be held liable under federal securities laws where the investment bank permitted

All of this remains true despite the fact that the Delaware legislature subsequently enabled and most corporations have elected to immunize (“exculpate”) directors from liability for breaches of care, even in the M&A context, and the leading Delaware court has disclaimed any per se rule requiring any particular “blueprint” for a sale.⁷⁹ US securities law reinforces this heightened duty of care when a deal involves stock currency and the target is publicly held. In such deals, the buyer is effectively issuing stock to the public (through the deal), with the result that its directors and officers have potential anti-fraud liability if they do not conduct (or have conducted for them) adequate “due diligence” to see that the prospectus delivered in advance of closing is accurate, materially complete and complies with technical regulatory requirements.⁸⁰

The content of fiduciary duties may also be shifted in subtle ways depending on the nature of a transaction. For example, in Delaware, a company selling itself for cash faces slightly different and effectively more stringent judicial review than one that accepts a merger with all stock as the deal currency, even the buyer is a much larger company, and in such situations, the target board may not openly prefer one bidder on the ground that its bid will benefit any “constituency” other than shareholders.⁸¹

In the UK, the Takeover Code (and now the Companies Act) forbid target directors from taking actions that tend to “frustrate” any bidder, essentially requiring them to be neutral between bidders – even if the target directors believe (for example) that one bidder is a stronger business partner than another. UK rules also effectively require target boards remain “neutral” as between different bidders. In the US, if a transaction involves contract provisions designed to deter competition that may arise after a bid emerges, those provisions (and possibly the entire deal) will also be subject to heightened judicial scrutiny, and while favoritism among bidders is not formally precluded, it is discouraged as a result of this review.⁸²

The strongest judicial review in the US is reserved for conflict-of-interest transactions – a sufficiently stringent type of review that it deserves separate attention (discussed in the next section). In addition, one type of conflict transaction – insider trading – in the US is subject to additional regulation in the context of tender offers.⁸³

its fairness opinion to be included in proxy solicitation materials, but without a genuine belief or reasonable basis for concluding that the economic assumptions upon which the fairness opinion was based were accurate).

⁷⁹ See DGCL § 102(b)(7); Edward P. Welch and Robert S. Saunders, *Freedom and its Limits in the Delaware General Corporation Law*, 33 Del. J. Corp. L. 845 (2008); Barkan, supra note 73.

⁸⁰ Securities Act of 1933 § 11; *Escott v. BarChris Construction Corp.*, 283 F. Supp. 643 (1968).

⁸¹ *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); Barkan, supra note 73.

⁸² *Id.*; *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

⁸³ SEC Rule 14e-3.

d. Fairness review, appraisals, and minimum payment requirements

M&A is sometimes subject to special “fairness” approval requirements, designed to insure that the transaction is “fair” to a designate set of beneficiaries – typically, shareholders (or non-controlling shareholders in the case of transactions in which controlling shareholders participate directly) – or, alternatively, that those beneficiaries receive fair compensation for any change in ownership or rights caused by the transaction. “Fairness” is as vague as it sounds, and is typically evaluated on a case-by-case basis, with a view towards whether target shareholders are being treated equally, whether the transaction provides them with value equivalent to the value of their shares prior to the transaction, and whether controlling fiduciaries are benefiting at their expense.

In the US, Delaware law requires that for any conflict of interest transaction, fiduciaries must affirmatively show that the deal is “entirely fair,” that is, at a fair price and the result of a fair process. All deal terms and elements of the process leading to the deal are subject to heightened *ex post* scrutiny, unless the deal meets stringent *ex ante* conditions.⁸⁴ If a court finds that the deal is not “entirely fair,” the result is that the fiduciaries are found to have violated their duties, with possible reputational implications.⁸⁵ The remedies available are not limited to compensation, but may exceed the compensatory value, potentially including the equivalent of punitive damages (although not typically so characterized).⁸⁶

In addition, in the US, appraisal rights may be an alternative form of fairness review available, but only for specified M&A transactions.⁸⁷ Appraisal rights permit any common shareholder to seek a judicial determination of the “fair value” of their shares, measured as if the transaction had not occurred (hence, excluding deal synergies), based on the value of the target firm as a whole, divided pro rata among common shareholders. Triggering transactions include cash mergers, mergers that rely upon short-form “squeeze-out” procedures that avoid a shareholder vote, and stock-for-stock mergers involving private

⁸⁴ Those conditions effectively and non-waivably pre-commit the target to a process that includes not only independent approval by a board, but also approval by disinterested shareholders. See M&F, *supra* note 21.

⁸⁵ E.g., *Valeant Pharmaceuticals Int'l v. Jerney*, 921 A.2d 732 (De. Ch. Dec. 1, 2006) (decision by directors to pay large cash bonuses to themselves and officers in connection with proposed transaction was found to fail entire fairness review).

⁸⁶ *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983) (lower court awarded arbitrary \$1 per share after freeze-out merger found to fail entire fairness test but merger price found to be above fair price for shares); *Valeant*, *supra* note 74 (president required to disgorge entire bonus and reimburse company for half of fees advanced by company for joint defense of president and CEO).

⁸⁷ On one aspect of the complex relationship between the “fair price” component of the entire fairness standard of review in Delaware with the “fair value” standard in appraisal settings, see, e.g., *In re Orchard Enterprises, Inc. Stockholder Litigation* 88 A.3d 1 (Del. Ch. Feb. 28, 2014) (fair value is a point estimate, fair value a range, so while fair value might exceed a merger price by more than 200%, that does not compel a finding of unfairness, although it is “certainly evidence of financial unfairness”). See also cases cited in note 41 *supra* (cases in which fair value or fair price is found to “approach” or be zero, or less, due to insolvency).

buyers or targets.⁸⁸ In Delaware (and indeed, in many US states), appraisal rights are not available in connection with asset or stock purchases, even if they have the same economic effects as a merger.⁸⁹

UK law regulates conflicts of interest differently, depending on whether the transaction is a bid or a scheme. For bids, elements of the Takeover Code create incentives for bidders to never obtain controlling but less than full ownership interests. For example, bidders are required to launch a “mandatory” acquisition bid at a regulated price once they acquire more than 30% of the target’s stock or if they acquire more shares after having acquired 30% but less than 50%, preventing creeping control bids and certain stock purchases raising a conflict of interest; bidders must obtain acceptances from at least 50% in the bid; and are required to conduct “squeeze-outs” once they obtain 90% ownership, and are constrained to pay a price that is at least equal to the highest price paid for shares (and no less than the price paid in their control bid).⁹⁰ Together, these rules prevent or substantively regulate with bright-line rules some of the types of M&A transactions that commonly involve conflicts of interest in the US. For transactions structured as schemes of arrangement in the UK, court approval is required, following receipt of a report from an independent “expert” finding that the share exchange ratio in the scheme is reasonable.⁹¹

In India, squeeze-outs are pursued through schemes of arrangement, and historically have been subject to little real judicial oversight or other regulation.⁹² The new Companies Act 2013 introduced one new protection similar to those required by UK law on schemes and induced by US fiduciary duty law – fairness opinions from independent investment banks on the value paid. It remains to be seen if the new statute will achieve minority shareholder protection absent broader judicial reforms to enhance the speed and efficacy of enforcement.⁹³

e. Regulation of deal terms, deal process, and deal-related debt

Both the US and the UK impose further restrictions on the substance and process for M&A transactions. Tender offers in the US and bids in the UK must offer all target shareholders

⁸⁸ DGCL § 262; Coates, “Fair Value,” *supra* note 23.

⁸⁹ *Hariton v. Arco Elecs., Inc.*, 188 A.2d 123, 125 (Del. 1963).

⁹⁰ Takeover Code Rule 9 (mandatory offer upon reaching 30% or acquiring more shares after having reached 30%, limited to cash or cash substitute, and at no less a price than the highest price paid during the 12 months prior to the offer); Companies Act §§ 979 (squeeze-outs at 90%).

⁹¹ Companies Act, Part 27, Chapter 2, Section 909.

⁹² Umakanth Varottil, *Corporate Governance in M&A Transactions*, Working Paper (2012), available at ssrn-id2042307 (last visited June 15, 2014).

⁹³ Umakanth Varottil, *The Protection of Minority Investors and the Compensation of their Losses: A Case Study of India*, Working Paper 2014/0001 (Feb. 2014), available at <http://law.nus.edu.sg/wps/> (“The Indian court system is plagued by delays, costs, and other inefficiencies ... [n]early 32 million cases are pending before different levels within the Indian judiciary...”).

the same consideration. Mergers in the US and schemes in the UK, by contrast, need not, although equal treatment is a strong norm generally followed, except where the point of the transaction is to provide ongoing ownership to a buyer or controller and cash to minority shareholders. Stock purchases, by contrast, do not necessarily benefit all target shareholders, and can be sequenced over time in such a way as to benefit some target shareholders differently (subject, in the UK, to the mandatory bid rule described above, and in the US, to fiduciary duty constraints on self-dealing). Asset purchases in some formal sense treat all shareholders equally, in that the consideration for the transaction flows to the corporation, which they own collectively; however, the control shareholders and/or board of a company selling assets need not then distribute that consideration to shareholders, and may thereafter use it in ways that may not benefit all shareholders equally.

Both the US and the UK impose limits on pre-bid solicitations of support for M&A transactions involving public targets. In the US, SEC proxy rules effectively limit bidders from obtaining support agreements from more than 10 shareholders of a public target without going public (and filing documents with the SEC) for the deal,⁹⁴ while in the UK, the Takeover Code forbids bidders from obtaining pre-bid agreements from more than six target shareholders.

Restrictions on the use of debt to finance M&A vary significantly across countries. In India, banks are not permitted to finance share acquisitions, including whole-company deals. However, this requirement is imposed on banks, rather than on deals, creating an imbalance between foreign acquirers (who can finance bids from foreign banks) and domestic acquirers (who are generally dependent on local banks for finance).⁹⁵ The Indian Finance Ministry is considering relaxing these restrictions. Even if they are relaxed, however, India's laws further ban "financial assistance,"⁹⁶ making debt-financed buyouts of private targets difficult, and those of public targets even more so.

Like India, and consistent with the EU's bank-protective Second Company Law Directive,⁹⁷ the UK generally forbids companies from providing "unlawful financial assistance" to a bidder to facilitate a bid or other stock purchase involving a public target,⁹⁸ although this

⁹⁴ SEC Rule 14a-2. Section 13(d) of the Securities and Exchange Act forces disclosure if the stock owned by supporting shareholders aggregates more than 5%.

⁹⁵ Umakanth Varottil, Financing Domestic M&A (June 2, 2014), available at <http://bit.ly/1nGGnbl> (last visited June 15, 2014).

⁹⁶ India Companies Act 2013, section 67.

⁹⁷ 77/91/EEC (13 December 1976), as modified in 2012/30/EU (25 October 2012).

⁹⁸ Companies Act, §§ 677-683. Assistance that is provided "out of distributable profits" is permitted in certain limited transactions, such as for employee compensation schemes. Unlawful financial assistance is a crime in the UK. *Id.*, section 680. Schemes of arrangement involving creditors are exempted, *id.*, section 681, but not those involving only shareholders, as in mergers via scheme, *id.* Separately, companies must be careful not to make illegal "disguised distributions" in the form of debt-financed M&A. See *Trevor v Whitworth* (1887) 12 App Cas 409.

prohibition was essentially eliminated for private targets in 2008. In addition, and perhaps more importantly, the UK requires that bids be fully financed before they are launched, with cash on hand or fully committed agreements from lenders, subject to “very limited” conditions.⁹⁹

The US M&A market does not have a similar “certain funds” or similar requirement relating to bids and offers. Nor does the US forbid “financial assistance.” Indeed, something sufficiently common in the 1980s to have earned a catch phrase, “junk-bond boot-strap bust-up two-tier takeover.”¹⁰⁰ US tax law was modified in the 1980s to limit interest deductions for debt that trades at a discount at original issuance, curtailing the tax subsidy of more extremely leveraged financing structures,¹⁰¹ and US bank supervisors have imposed modest constraints on the ability of banks to take on excessive risks in the “leveraged loan” market that funds the largest buyouts.¹⁰²

Instead, US leans on target fiduciary duties and court-developed M&A-specific successor liability doctrines to reinforce contract and general creditor-protection laws such as fraudulent conveyance statutes.¹⁰³ Because target fiduciaries are not strictly required to remain neutral as between bidders, they have more flexibility than in the UK to prefer a bidder based on financing certainty, and they are at risk if they sell to a looter.¹⁰⁴ More generally, even when a buyer seeks to limit the liabilities it takes on – for example, by purchasing assets or employing a subsidiary to carry out the deal – it may find that many special types of liabilities are imposed on the buyer/parent by virtue of control of the target’s business.¹⁰⁵ In addition, depending on deal structure, post-deal consolidation choices, and

⁹⁹ Takeover Code, Rule 2.7; Slaughter and May, When Will a Commitment Letter Constitute a Firm Commitment?, Financing Briefing (July 2008).

¹⁰⁰ Martin Lipton, Takeover Bids in the Target’s Boardroom, 35 Bus. Law. 101 (1979).

¹⁰¹ See generally Internal Revenue Service, Guide to Original Issue Discount (OID) Instruments, Publication 1212 (Dec. 2013), available at <http://www.irs.gov/pub/irs-pdf/p1212.pdf> (last visited June 13, 2014).

¹⁰² E.g., Office of the Comptroller of the Currency, Federal Reserve System, and Federal Deposit Insurance Corporation, Interagency Guidelines on Leveraged Lending, 78 Fed. Reg. 17,766 (Mar. 22, 2013) (setting forth tightened principles for agency-supervised banks to engage in leveraged lending, including lending for buyouts; stating that “Generally, a leverage level after planned asset sales (that is, the amount of debt that must be serviced from operating cash flow) in excess of 6X Total Debt/EBITDA raises concerns for most industries...”).

¹⁰³ See J. H. Ginsberg, M. Burgess, D.R. Czerwonka, Z.R. Caldwell, Am. Bankr. Inst. L. Rev. (2011) (describing fraudulent conveyance law, noting uncertainties in how that law is applied to buyouts, and recommending more rule-like revisions, such as specifying probability at which cash-flow insolvency becomes “reasonably foreseeable”).

¹⁰⁴ E.g., *Michael R. Harris v. Donald J. Carter, et al.*, 582 A.2d 222 (Del. Ch. 1990).

¹⁰⁵ E.g., in the US: Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. § 9607 et seq. (environmental liability based on control of real property, not formal ownership or control at time environmental harm created); National Labor Relations Act, 29 U.S.C. § 158(a)(5) (collective bargaining contracts and duty to bargain based on bargaining unit, not on formal corporate structure); the Civil Rights Act of 1964, 42 U.S.C.A. § 2000d (liability for unlawful discrimination may run to successor); Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), 12 U.S.C. § 1821(k), and Federal

the relevant jurisdiction's law, a buyer or its subsidiaries may become subject to all of a target business's liabilities under common law doctrines variously labeled "agency," "de facto merger" or "successor liability."¹⁰⁶ While such doctrines do little more than fraudulent conveyance statutes to constrain total leverage resulting from a given deal, they do constrain the temptation to use M&A or restructuring to shift or amplify risks to creditors, or to extract value in violation of conventional priorities among claimants.

f. Bans or structural limits

Finally, many laws effectively ban or impose structural limits on M&A. At the request of a creditor, a court in the US may be willing to enjoin transactions that would cause a company to become insolvent, particularly if they involve transfers of value to shareholders or a subset of creditors. Banking laws in the US forbid acquisitions by banks of non-banks, or vice versa,¹⁰⁷ while in the UK the separation of banking and commerce is preserved through the discretion of bank supervisors to refuse permission for non-banking entities to enter banking on prudential ("safety and soundness") grounds. M&A transactions that would create monopolies or monopoly power are banned, unless (as is typical) a buyer is prepared to divest parts of the target's business to reduce competitive concerns. Defense contractors, airlines and telecommunications companies are typically forbidden from being acquired by

Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Pub. L. No. 102-242, 105 Stat. 2236 (codified in scattered sections of 12 U.S.C.) (liability for bank fraud may run to successor, not limited to formal corporate party engaged in fraud); see generally Mark J. Roe, *Mergers, Acquisitions, and Tort: A Comment on the Problem of Successor Corporation Liability*, 70 Va. L. Rev. 1559 (1984) (discussing successor liability in tort); John H. Matheson, *Successor Liability*, 96 Minn. L. Rev. 371 (2011) (discussing state and federal common law successor liability doctrines); Michael Carter, *Successor Liability Under CERCLA: It's Time to Fully Embrace State Law*, 156 U. Pa. L. Rev. 767 (2008) (successor liability under CERCLA).

¹⁰⁶ See cases in note 32 supra; see also *Magnolia's at Bethany, LLC v. Artesian Consulting Engineers, Inc.*, 2011 Del. Super. LEXIS 435 (Del. Super. Sep. 19, 2011) (Delaware Superior Court articulating narrowly circumscribed "de facto merger" doctrine requiring either express assumption of liabilities or continuation of corporate entity with the same owners, directors, officers and cessation of target company); *Xperex Corp. et al. v. Viasystems Technologies Corp.* C.A. No. 20582-NC (July 22, 2004) (Delaware Chancery Court articulating broadly framed "de facto merger" doctrine to prevent "sham transactions to achieve mischief" or "to seek to shelter assets from creditors"); *Ramirez v. Amsted Industries, Inc.*, 431 A.2d 811 (Supr. Ct. N.J. 1981) (New Jersey court articulating "flexible" de facto merger test based on multiple factors, including continuity of ownership, cessation of target business, continuity of management, and assumption of liabilities ordinarily need to operate business); *Kaminski v. Western MacArthur Co.*, 175 Cal. App. 3d 445 (Ct. App. Cal. 1985) (California court articulating broadly framed "substantial continuity" doctrine imposing tort liability on continued product lines and businesses, regardless of corporate form); *U.S. v. Generations Healthcare, LLC*, 2012 U.S. Dist. LEXIS 116431 (U.S.D.Ct. N.D. Ill. Aug. 14, 2012) (US District Court articulating successor liability doctrine for purposes of False Claims Act as part of US federal common law); *Fitzgerald v. Fahnestock & Co., Inc.*, 286 A.D.2d 573, 574 (N.Y. App. Div. 2001) (New York case stating factors for finding of de facto merger).

¹⁰⁷ Bank Holding Company Act of 1956 § 1972; see also Investment Company Act of 1940 §6 and Internal Revenue Code §§ 851-852 (together effectively limiting the ability of mutual funds to invest in control stakes of portfolio companies); in Europe, see also the "UCITS" directives, 2001/107/EC (the "Management Directive") and 2001/108/EC (the "Product Directive") (1/21/02) and 85/611/EEC (12/20/85), which ban collective

foreign or foreign-controlled buyers, and restrictions on foreign ownership typically extend to more industries in developing nations.¹⁰⁸

V. What types of M&A transactions actually take place, and what effects does law have?

What effects do the foregoing laws have on the patterns of deal making in the US, the UK and India? Although complete data necessary to answer such a question are not available, public data does provide a basis for some general observations about such patterns.

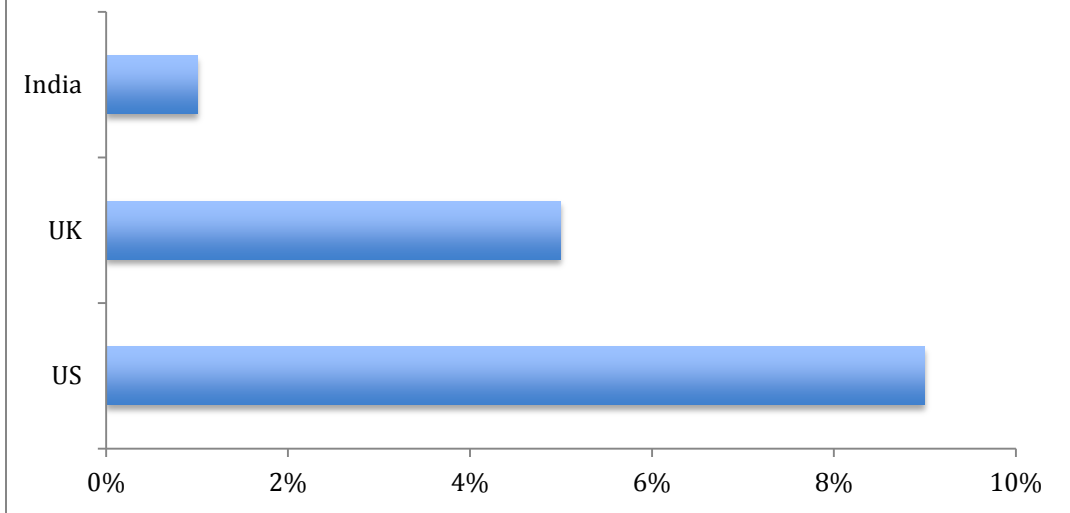
First, as illustrated in Figure 1, the overall US legal environment is highly conducive to M&A. US M&A levels are the highest in the world. This is true both in dollars and in numbers of deals, absolutely and (as depicted in the figure) relative to the size of the relevant economies, for both public and private targets, and across a range of industries. UK law is also highly facilitating, with robust M&A markets, albeit modestly less so for public targets than in the US. In part this is due to the rigidity of some UK laws that benefit target shareholders conditional on a bid, but also have modest inhibitory effects on bidders considering whether to initiate a bid.¹⁰⁹ The UK's ban on financial assistance also likely has a constraining effect on buyouts, although buyout volumes in the UK and elsewhere in Europe suggest that the UK's ban on financial assistance has had only limited effect, in part because its focus on debt incurred for transactional purposes does not extend to debt incurred near in time but not as part of a stock purchase.¹¹⁰ Deals in India have increased in significance, both absolutely and relative to the Indian economy, but remain well below levels in the US and the UK.

¹⁰⁸ See note 38 supra.

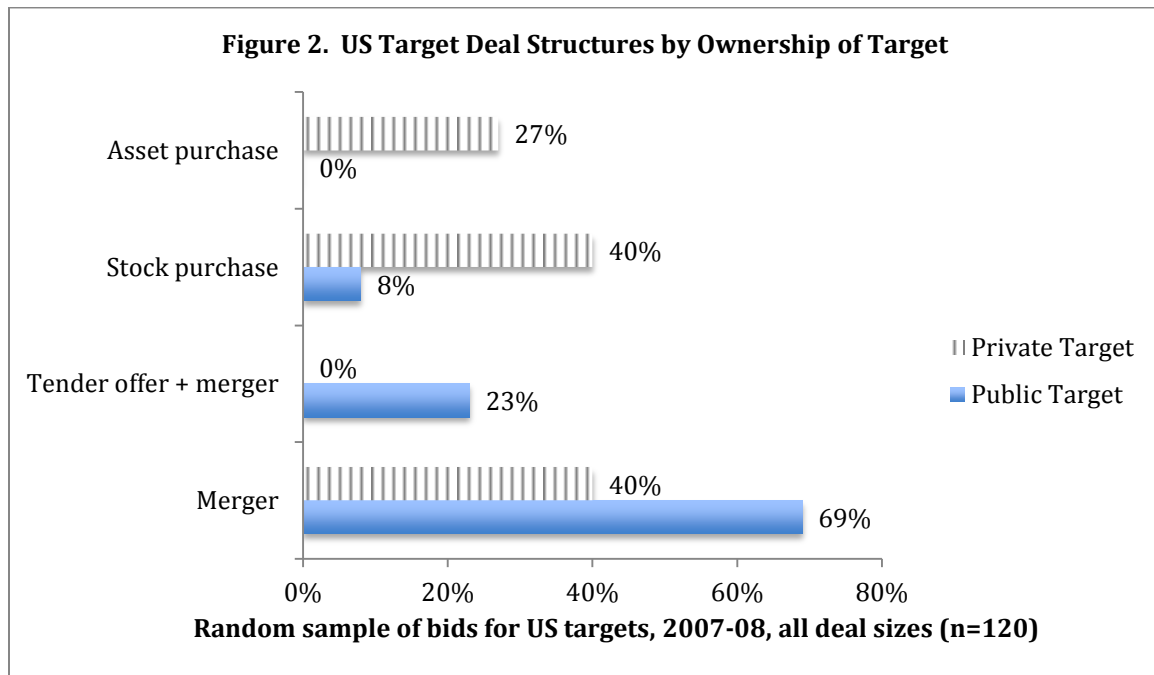
¹⁰⁹ See John C. Coates, M&A Break Fees: U.S. Litigation versus U.K. Regulation, *Regulation versus Litigation: Perspectives from Economics and Law*, Daniel Kessler, ed. Chicago: University of Chicago Press (2011).

¹¹⁰ L. Enriques, EC Company Law Directives and Regulations: How Trivial Are They?, 7 U. Penn. J. Int'l Econ. L. 1 (2006); Eilis Ferran, Regulation of Private Equity-Backed Buyout Activity in Europe, ECGI Law Working Paper No. 84/2007 (May 2007).

Figure 1. Deal Volume / GDP in US, UK and India, 2013



Second, deal structures are highly dependent on the ownership structures and sizes of the companies involved. In the US, as illustrated by Figure 2, deal structures take on a completely different distribution for public and private targets. In the UK, deals for larger public targets are more likely to use a scheme of arrangement than smaller deals, which are more likely to rely on bids.¹¹¹ In India, M&A transactions are almost completely structured as asset and stock purchases, owing to the concentrated controlling ownership structures, even among India's largest public companies.¹¹²

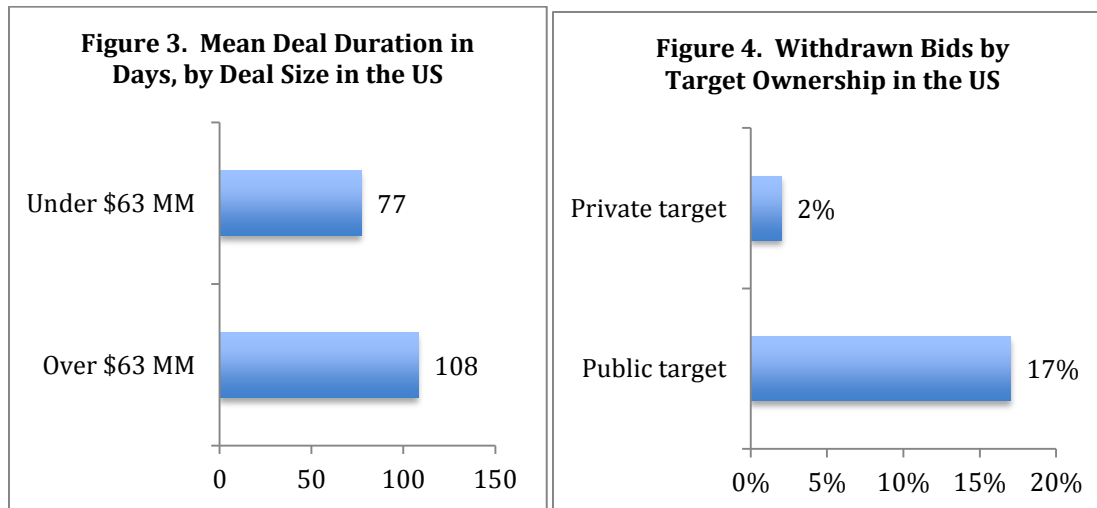


Third, because deal regulation has a clear impact on the way deals proceed. For example, as illustrated in Figure 3, deals take substantially longer to complete if they are large enough to trigger antitrust review in the US than if they do not.¹¹³ Similarly, as illustrated in Figure 4, deals are substantially more likely to be withdrawn once announced, if they involved a public target in the US.¹¹⁴ Some effects show up across jurisdictions, too: acquisitions of US public targets (most of which are mergers that involve at least some non-cash consideration, and so require registration of securities with the SEC) typically take 60 to 90 days from announcement to complete; those of UK public targets take 25 to 30 days from announcement; and those of Indian public targets either occur simultaneously with announcement (where they are structured as sales of control blocks owned directly or indirectly by one individual or family controlling shareholder to another) or take four to six

¹¹¹ Levy et al., *supra* note 38. One advantage of schemes is they can be structured so as to not trigger the small but non-trivial stamp tax liability imposed in the UK (but not in the US) only transfers of stock via bids. See Payne, *supra* note 46.

¹¹² For an overview of M&A in India, see Kosturi Ghosh, Ipsita Chowdhury and Vallishree Chandra, Public mergers and acquisitions in India: Overview, available at <http://us.practicallaw.com/3-503-11082q=India> (last visited June 6, 2014).

months (where they are structured as asset purchases or, less commonly, bids for public company shares), or up to a year in the rare scheme of arrangement.¹¹⁵ Bid withdrawal rates are far higher in India for private target deals than in either the US or the UK, and while some of the differences may be attributable to non-legal factors, the legal process for M&A is likely to be a partial cause as well.



A fourth empirical finding is also clear: M&A transactions generally generate significant gains to target shareholders who sell, regardless of jurisdiction. Premiums over pre-deal market prices for public targets average between ~25% and ~50%, depending on time period and sample, in each of the US, UK and India.¹¹⁶ (In India, however, those gains may not be shared with minority shareholders in the typical deal structure, in which a control block is sold without a corresponding acquisition of other shares.) Comparisons of observed premiums across jurisdictions are difficult, in aggregate, due to differences in ownership, finance, and the economics motivating deals, so it is less clear whether law has an important influence on the relative benefits of M&A to target shareholders.

Data on and studies of topics of more general social, political and economic interest – such as whether M&A transactions are good for bidders or society as a whole – are far more problematic. Part of the difficulty is that M&A is endogenous to a large number of forces, beyond corporate law, or even the law of M&A generally: finance, macroeconomic activity, monetary policy, politics, tax, culture, etc. Controlling for such factors is necessary to draw reliable inferences about the effects of law, but doing so is difficult if not impossible, given

¹¹³ The trigger for review under the Hart-Scott-Rodino Act in the years of the sample (2007-2008) was ~\$63 million. Coates, *supra* note 17. These bids are from the same sample used to create Figure 2.

¹¹⁴ *Id.*

¹¹⁵ See, e.g., <http://www.sec.gov/Archives/edgar/data/1144967/000119312508203048/dex41.htm>.

¹¹⁶ For the US, see Richard Bruner, *Applied Mergers and Acquisitions* (Wiley & Sons 2004), chapter 3, exhibit 3.3 (summarizing studies, all finding positive returns to target shareholders).

limits on the degree or frequency of variation in or observability of such factors.¹¹⁷ As a result, it remains a topic of some dispute even in the largest M&A jurisdiction whether M&A is, on balance, good for bidders.¹¹⁸

Similarly, the effects of M&A generally on non-shareholder constituencies, such as employees or creditors, are disputed. M&A generates substantial transaction costs, which might be viewed as wasteful rents (from a social perspective) if the net result of M&A even to both bidder and target shareholders from a typical deal is zero or nearly so. In the US, the tax shield from higher leverage incurred through debt-financed M&A may also represent a form of rent-seeking, but it is unclear why managers would not incur similar levels of tax-reducing debt without M&A (other than, perhaps, as a form of agency cost, in which taxpayers may be benefiting at shareholder expense). Employees are commonly laid off following mergers, particularly among general managers, as the buyer can achieve economies in management (e.g., no need for two highly paid general counsels), but the most highly paid employees often receive side payments in the form of vested options or stock, or “*golden parachutes*,” and many find employment quickly. Some M&A transactions lead to more widespread layoffs, but it is hard to test whether such layoffs would have occurred anyway, as when M&A is a channel for globalization, or whether the firms involved are able to create new jobs at a faster pace than they would have done without M&A. Labor unions used to oppose hostile takeovers, but union pension plans now commonly embrace corporate governance strategies that tend to increase M&A. Few M&A transactions generate antitrust concern sufficient to attract more than minimal review by US antitrust agencies. Banks and other lenders are sufficiently unconcerned about the effects of M&A on risk or debt levels that they commonly omit event-risk covenants that would provide protection in the M&A context. Larger creditors may be protected by other means, while smaller creditors are “non-adjusting,” in the sense that the benefits of seeking contract protections may be outweighed by the transaction costs of doing so, making non-action by larger creditors of uncertain significance for estimating the effects of (leveraged or leverage-increasing) M&A on creditors generally.

¹¹⁷ Pavel G. Savor and Qi Lu, Do Stock Mergers Create Value for Acquirers, Working Paper (2014), available at ssrn-id881513.pdf (last visited June 13, 2014).

¹¹⁸ Id. For a study of the combined effect of M&A in the 1990s on bidders and targets, and on operational performance following mergers, see Gregor Andrade, Mark Mitchell and Erik Stafford, New Evidence and Perspectives on Mergers, 15 J. Econ. Persp. 103 (2001). The largest, relatively recent studies suggest M&A transactions involving private US targets is good, on average, for owners of public company bidders, if only modestly so, while bids for public targets are often if not always bad. E.g., Jie Cai, Moon H. Song and Ralph A. Walkling, Anticipation, Acquisitions and Bidder Returns: Industry Shocks and the Transfer of Information across Rivals, 24 Rev. Fin. Stud. 2241 (2011); Jeffrey Netter, Mike Stegemoller and M. Babjide Wintoki, Implications of Data Screens on Merger and Acquisitions Analysis: A Large Sample Study of Mergers and Acquisitions from 1992 to 2009, 24 Rev. Fin. Stud. 2315 (2011).

VI. Conclusion: what do the variations in types and modes imply about law generally?

What general conclusions can we draw from this survey? At a very high level, corporate and securities law across jurisdictions treats M&A transactions differently from other, less dramatic and more routine types of transactions. Against a background of other laws that shape and structure the M&A process (tax, antitrust, etc.), corporate and securities law simultaneously facilitate M&A, by reducing collective action costs and the risk of strategic hold-up, but also impose tighter disclosure, process and substantive constraints on M&A transactions. As a general rule, constraints are tighter for deals involving public companies, where dispersed owners are in need of more information and are less capable of protecting their own interests without additional protections, and are tightest for transactions in public companies that represent conflicts of interest (or would do so if permitted).

A second take-away from the survey is that different countries regulate M&A differently, and exhibit different patterns in M&A forms. These differences reflect at least in large part long-standing differences in structural features of the markets, particularly ownership structure, which itself may be at least in part a function of corporate law and governance. In the US, ownership dispersion led to the use of the collective-action cost-economizing merger; in the UK, greater institutional political power achieved shareholder-protective takeover regulation that has been extended largely if incompletely to schemes; and in India, schemes are used much less frequently, relative to simpler negotiated stock purchases, in part because the latter do not trigger a number of legal requirements imposed on the former, but also because they are unnecessary given the frequency of control blocks even among large listed companies, and because bidders often appear content to acquire control, rather than 100% ownership, as is typical in the US and the UK.

But other cross-country variations also seem to reflect the way that (as in chaotic systems) seemingly small differences in starting conditions can ramify and persist in the face of similar legal, historical, and economic conditions (common law, English language and heritage, republican democracies, long coastlands, dependence on trade, and for the past twenty years, at least, a relatively unmixed commitment to regulated capitalism) and strong market pressures to produce an efficient methods to allocate resources rapidly through M&A. In the UK, courts play a background role in M&A, even when formally required to approve a scheme. Contested litigation is rare, and bright-line rules set (at least initially) by stock exchanges (which in turn are dominated by institutional investors) screen out whole classes of transactions that might harm the interests of shareholders, while other laws that protect creditors (e.g., against “financial assistance”) derive from the bank-centered governance politics of the early European Community. In the US, by contrast, the watchword is flexibility, but also litigation. Courts are central, even without a formal role in approving any given deal, and lawsuits are so commonplace as to transform the (Delaware) courts into a quasi-regulatory agency creating “regulation” as much as resolving disputes, driving deal-related disclosure decisions as much as the rival regulatory body (the SEC) with formal

authority over disclosure. In India (with admittedly a very different history and more recent path to its current international position and economic and legal structure), litigation is common, but unavailing, given the delays in the court system, the regulatory body overseeing the stock exchanges has achieved the most discipline over corporate controllers in the M&A context, but M&A regulation is multifarious and frequently overshadowed in a given deal by the complex and often informal body of regulations of ownership of business itself. These differences in the details of how M&A is regulated are far greater than an outside observer might expect. Minor variations in similar laws with similar goals in similar legal systems, in other words, can have real effects on the amount and nature of economic activity.

A third and final bottom-line of the survey is that some constraining aspects of M&A law can sometimes be evaded, and are. This stems from the fact that the corporate form – by interposing a legal entity between owners and businesses – makes it possible for economically equivalent transactions to be accomplished with a variety of transactional forms – asset purchases, as with non-corporate actors, but also stock purchases (including bids and tender offers) and mergers, schemes and squeeze-outs. Because M&A law does not apply equally to all methods of pursuing a given transaction, opportunities arise for M&A to be structured to reduce the effect of or avoid some of these laws. Hence, we see the move from bids to schemes in the UK, illustrating both the incentive to avoid unnecessary (stamp) taxes, but also the greater flexibility of the scheme. Similarly, in the US, we see the emergence of the tender offer as a mechanism for hostile takeovers in the 1980s, followed by its use in negotiated acquisitions (followed by squeeze-out mergers), to reduce the time needed to obtain control, while ensuring 100% ownership. Moreover, shifts in deal patterns respond to legal changes, and are themselves of economic consequence. Ironically, these patterns of avoidance are evidence that the law does in fact sometimes bind. If M&A laws were trivial or its constraints inconsequential, such patterns would not appear.

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