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## ABSTRACT

**Name of University:** Durham University

**Name:** Sarah Emily Morley

**Degree Title:** PhD

**Thesis Title:** Takeover Litigation: the US does it more than the UK, but why and does it matter?

**Submission Date:** March 2017

This thesis begins by describing the regulatory regimes of takeovers in the UK and US, and maps the litigation landscapes of both jurisdictions. In order to first map or *describe* the litigation landscapes, data was collected to reveal the extent of the UK's propensity to litigate during takeovers. Although data ascertaining takeover litigation levels existed in the US no current study had yet established the levels in the UK. It is revealed that in the US 87 percent of takeovers are subject to litigation, whilst in the UK the figure is less than one percent. Current literature has not yet attempted to explain exactly why the US and UK differ so widely, considering their very similar market systems. The focus of this thesis is then to *explain* this difference and debunk some of the more obvious presumed explanations (i.e. "the US is just more aggressively litigious") and identify some lesser known reasons. As the main instigators of US litigation are target shareholders alleging their directors have breached a fiduciary duty a number of explanations inevitably arise from this particular scenario. A simplistic uni-causal explanation is therefore rejected and instead this thesis offers four candidates for explaining the disparity. These are, firstly, that US shareholders benefit from more extensive "causes of action." The second explanation encompasses the different "forms of action" that are available to shareholders in the UK and US to pursue these causes of action; in the US the class action is the favoured form whereas in the UK shareholders are limited to the derivative claim. The third explanation concerns the role played by the existence of the Code, and its administration by the Panel. It is argued that these UK institutions do much to suppress takeover litigation in general. The fourth and final explanation is the rather amorphous concept of "litigation culture." Finally, the impacts of the diverging propensities to litigate on factors such as cost and speed on the takeover process are then evaluated.



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# Takeover Litigation: the US does it more than the UK, but why and does it matter?

Sarah Emily Morley

**Doctor of Philosophy**

in the School of Law, Durham University

2017



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**TABLE OF CONTENTS**

**Preliminaries**

**List of Abbreviations** **9**

**Declaration and Statement of Copyright** **10**

**Acknowledgements** **11**

**Chapter One: Introduction**

**1.1 Introduction** **12**

**1.2 Thesis Outline** **14**

**1.3 Methodology** **16**

**Chapter Two: The Theory of the Market for Corporate Control**

2.1 **Introduction** **19**

2.2 **The Merits of the Market for Corporate Control** **21**

2.2.1 Economic Efficiency 21

2.2.2 Disciplinary Device 23

2.2.3 Minority Shareholder Protection 25

2.3 **Criticisms of the Market for Corporate Control** **26**

2.3.1 The Ideal Market and Stock Market Efficiency 26

2.3.1.1 Available Information 28

2.3.1.2 The Rational Investor 33

2.3.2 The Market for Corporate Control does not act as a Disciplinary Device 35

2.4 **Alternative Disciplinary Mechanisms?** **38**

2.5 **Conclusion** **40**

**Chapter Three: UK Takeovers: Practices and Regulation**

3.1 **Introduction** **42**

3.2 **Offers and Schemes of Arrangement** **43**

3.2.1 The Process of a Takeover Offer 44

3.2.2 The Process of a Scheme of Arrangement 48



المنارة للاستشارات

www.manaraa.com

3.3 **UK Regulatory Regime: Company Law** **50**
3.3.1 Part 28 of the Companies Act 2006 51
3.3.2 The Panel 51
3.3.3 The Code 55
3.3.4 Enforcement of the Code 60
3.3.5 Change in the Legal Status of the Panel 61
3.3.6 Squeeze-out and Sell-out Rights 62
3.3.7 Part 26 of the Companies Act 2006 63
3.3.8 Directors' Duties 64
3.3.8.1 Duty to Act Within Powers 65
3.3.8.2 Duty to Promote the Success of the Company 67
3.3.8.3 Duty to Exercise Reasonable Skill, Care and Diligence 69
3.3.9 Causes of Action under Company Law 69
3.3.9.1 Unfair Prejudice 69
3.3.9.2 Other Causes of Action under Companies Act 2006 70
3.4 **Other Relevant Regulation** **72**
3.4.1 Other Legislation 72
3.4.2 Contract Law 73
3.4.3 Judicial Review 74
3.4.4 Common Law (non-directorial) Fiduciary Duties 74
3.5 **Conclusion** **75**

**Chapter Four: UK Takeover Litigation: Typology and Propensity**
4.1 **Introduction** **76**
4.2 **Typology of Range of Complaints** **77**
4.2.1 Explanations 80
4.3 **Causes of Action** **82**
4.4 **Method of Search** **87**
4.4.1 Reported Versus Non-Reported Cases 87
4.4.2 Cases Recorded Since 1960 88
4.4.3 Jurisdictions 88
4.4.4 Substance of Claim 88



المنارة للاستشارات
www.manaraa.com

4.4.5 The Search 88

**4.5 The Findings** **89**

4.5.1 Common Causes of Action 91

4.5.2 Propensity to Litigate 92

4.5.3 Instigator and Target of Litigation 93

4.5.4 Outcome of Litigation 96

4.5.5 Summary of Findings 97

**4.6 The Code and Panel Decisions** **98**

**4.7 Conclusion** **106**

**Chapter Five: US Takeovers: Practices and Regulation**

**5.1 Introduction** **107**

**5.2 US Practices: Single-Step Mergers and Two-Step Mergers** **107**

5.2.1 Single-Step Merger 108

5.2.2 Two-Step Merger (Tender Offer) 111

5.2.3 Stakebuilding 112

**5.3 US Regulatory Regime: Federal Regulation of Takeovers** **113**

5.3.1 Federal Law 115

5.3.1.1 The Securities Act of 1933 116

5.3.1.2 The Securities Exchange Act of 1934 117

5.3.1.3 The Williams Act 1968 117

5.3.1.4 The SEC 118

5.3.2 Federal Regulation of Single-Step Merger Process 120

5.3.3 Federal Regulation of Two-Step Merger Process (Tender Offer) 121

5.3.4 Federal Regulation on Stakebuilding 123

**5.4 US Regulatory Regime: State Laws** **126**

5.4.1 Fiduciary Duties 127

5.4.2 State Law: The General Corporation Law 128

5.4.3 Duty of Loyalty, Care and Disclosure 129

5.4.4 Duty of Good Faith 131

5.4.5 The Business Judgement Rule 133

5.4.6 Enhanced Fiduciary Duties 134



المنارة للاستشارات
www.manaraa.com

5.4.6.1 The Unocal and Revlon Standards 135

5.4.7 "Just Say No": Managerial Discretion 140

5.4.8 Anti-takeover Statutes 143

5.5 **Conclusion** **145**

**Chapter Six: US Takeover Litigation: Typology and Propensity**

6.1 **Introduction** **147**

6.2 **Typology of Range of Complaints** **147**

6.3 **Typology of the Cause of Action** **149**

6.3.1 Federal Level Causes of Action 149

6.3.2 State Level Causes of Action 152

6.4 **US Empirical Studies** **158**

6.4.1 Cain and Davidoff Solomon 158

6.4.2 Daines and Koumrian 158

6.5 **Propensity to Litigate** **159**

6.5.1 Cain and Davidoff Solomon's Findings 159

6.5.2 Daines and Koumrian's Findings 163

6.6 **Comparative Analysis** **165**

6.7 **Conclusion** **167**

**Chapter Seven: Explaining the Litigation Landscapes of the UK and US**

7.1 **Introduction** **169**

7.2 **Differences in "Causes of Action" in the UK and US** **172**

7.2.1 Are the Obligations of (Target) Directors More extensive in the US than the UK? 172

7.2.1.1 A Red-herring: Some Additional, but Irrelevant, US Regulatory Obligations 172

7.2.1.2 Relevant Ways in Which Target Directors' Obligations *are* More Extensive in US 175

7.2.2 The Key Difference: to whom are these Duties Owed? 180

7.3 **Differences in the "Forms of Action"** **183**

7.3.1 Derivative Claims 184

7.3.2 Class Actions 190

7.3.2.1 Attorney Fees in Shareholder Class Actions 191

7.3.3 UK Group Litigation Orders and Representative Actions 196



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7.3.4 Class Actions: Evidence from Australia 199

**7.4 Presence of the Panel and the Code** **200**

7.4.1 The Panel as an Alternative to Litigation 201

7.4.2 The Courts' Refusal to "Step on Toes" of the Panel 210

7.4.2.1 Courts Approach to Litigation in Schemes of Arrangements 212

7.4.3 The No Frustration Principle and Tactical Litigation 215

7.4.4 The Australian Takeover Panel: a Point of Comparison 219

**7.5 Litigation Culture** **220**

7.5.1 Acceptability of Litigation 221

7.5.2 Positive Attitude towards Litigation 223

7.5.3 Behaviour and Takeover Etiquette 224

**7.6 Conclusion** **227**

**Chapter Eight: Impacts of the Propensity to Litigate**

**8.1 Introduction** **230**

**8.2 Impact on Speed of Takeovers** **231**

8.2.1 Speed of Takeovers in UK 231

8.2.2 Speed of Takeovers in US 233

8.2.3 The Significance of the Speed of Takeovers 236

**8.3 Impact on Cost of Takeovers** **239**

8.3.1 UK Costs 239

8.3.1.1 Panel Document Charges 240

8.3.1.2 Panel PTM Levy 241

8.3.1.3 Panel Exempt Status Charges 241

8.3.1.4 Costs Relating to Panel Complaints and Breaches of the Code 242

8.3.2 Costs of US Litigation 243

8.3.3 Distribution of Litigation Costs in the UK and US 244

8.3.4 The Significance of the Cost of Takeovers 246

**8.4 Impact of Litigation on US Target Shareholders** **246**

8.4.1 Do US Target Shareholders Achieve Better Settlements from Litigation? 246

8.4.2 Do US Target Shareholders Obtain Better Disclosures from Litigation? 249

8.4.3 Agency Problems and Corporate Governance 255



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8.5 **Impact on the Market for Corporate Control** **260**

8.5.1 Does the Presence of Litigation Suppress the Market for Corporate Control? 260

8.6 **Conclusion** **262**

**Chapter Nine: Conclusion**

9.1 **Conclusion** **264**

**Appendices** **272**

**Bibliography** **315**

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## ABBREVIATIONS

| | |
|---|---|
| CA | Companies Act 2006 |
| CLERP | Corporate Law Economic Reform Program |
| CPR | Civil Procedure Rules |
| DGCL | Delaware General Corporation Law |
| DLLC Act | Delaware Limited Liability Company Act |
| EEA | European Economic Area |
| FCA | Financial Conduct Authority |
| FSMA | Financial Services and Markets Act 2000 |
| FTA | Fair Trading Act 1973 |
| GLO | Group Litigation Order |
| MA | Misrepresentation Act 1967 |
| MCC | Market for Corporate Control |
| TSvTD | Target Shareholder v Target Director |
| US | United States of America |
| UK | United Kingdom |



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# Chapter One

# Introduction

## 1.1 Introduction

This project fits within the area of research which studies the regulation of takeovers. More specifically, it provides a comparative study of certain aspects of the regulatory regimes of the United Kingdom and the United States. There are many similarities between the corporate governance systems of the UK and the US. Indeed, they are often labelled, collectively as the "Anglo-American" system, and archetypal examples of "outsider" governance regimes, to contrast them with the "insider" systems that characterise many continental European or Asian states. Yet, as Armour and Skeel have noted, when it comes to takeover regulation, the UK and US are remarkably divergent in both substance (the rules) and mode (who it is that does the regulating). They noted that the US 'looks to formal law, whereas norms-based self-regulation holds sway in the UK.'[1]

In the UK, takeovers are regulated by the Takeover Code (the "Code"), a set of "soft law" rules that are written and overseen by the Panel on Takeovers and Mergers (the "Panel"). The rules of the Code place great importance on protecting shareholders, and allowing *them* to control the takeover process. The directors of the "target" company (the company that is the subject of the takeover) have only limited means of influencing the outcome of the takeover bid. By contrast, the takeover process in the US is regulated to a much greater extent by hard law. Instead of the soft law of the Code, the most important rules are found in federal regulation and state law, and in place of the active oversight of the Panel, the enforcement of the rules falls to the courts.

One striking difference in the takeover regimes of the UK and the US, alluded to already above, concerns the extent to which "defensive" or "frustrating" action by target directors is possible. In the UK, as has been noted, the central philosophy of takeover regulation is

[1] John Armour, David Skeel, 'The Divergence of U.S. and UK Takeover Regulation' (2007) University of Pennsylvania, Institute for Law & Economic Research Paper No. 08-24



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"shareholder sovereignty;" shareholders determine the outcome of the bid, and target directors cannot deny them the opportunity to do so. In the US, it is argued, target directors enjoy rather greater power to influence bid outcomes. This question of the extent of directorial discretion is undoubtedly an important aspect of takeover regulation, and this is reflected in the voluminous literature that has emerged comparing and evaluating the difference between the UK and US approaches. This difference is not, however, the focus of this thesis. Instead, this thesis addresses a related, but surprisingly much less studied,[2] aspect of the two regimes. It concerns the role that *litigation* plays within the takeover process, as a means of resolving the complaints that takeover participants may have.

Referring to the "role" of litigation is a little vague, and it will be helpful to describe briefly the *three*, separate, issues that this reference to the "role" of litigation encompasses (each will be expanded on somewhat in this introductory chapter below). The first issue is a *descriptive* one. To what extent *do* takeover participants in the UK, and in the US, resort to litigation? This work shall aim to provide both an "aggregate picture" of the overall propensity to litigate in the two jurisdictions, but also unpack the detail to some extent, asking who are the parties to such actions, and what complaints are the subject of litigation?

Having, in this way, described the situation in the UK and US, and the extent of the differences between them, the second issue that shall be considered moves beyond description to *explanation*. How can the differences, which have been identified between the two jurisdictions, be explained? It might be thought, from what has been said so far, that the

[2] Whilst Armour and Skeel's work very briefly commented on how the different mode and substance of the regimes might impact on the levels of litigation it was limited in scope and specifically addressed hostile takeovers. Their work paid little specific attention to explaining litigation practices and the reason for the diverging levels, and the specific impact these practices might have in detail. Their work was also published in 2007 before the publication of US empirical studies, which this project uses utilises. Literature responding to Armour and Skeel (e.g. Coffee John, Sale Hillary, 'Redesigning the SEC: Does the Treasury Have a Better Idea?' (2009) 95 Virginia Law Review 707) has also not yet addressed these issues. In terms of *impact* of different propensities to litigate, much has been written about the general impacts of takeovers, but little has focused purely on the impact of litigation to the takeover process. Mukwiri (Mukwiri, Jonathan, 'The Myth of Tactical Litigation in UK Takeovers' (2008) 8 Journal of Corporate Law Studies 2), for example, has examined likely levels of future litigation in reaction to regulatory changes, yet nothing has been written, specifically, on the impact on shareholders propensity to litigate. Ogowewo (Tunde I Ogowewo, 'Tactical Litigation in Takeover Contests' (2007) Journal of Business Law 589) has evaluated the scope for tactical litigation after the implementation of the EU takeover directive, and the new statutory grounding of the Panel and the Code. However, this work does not address the current levels of litigation in the UK nor explain the lack of a propensity to litigate and its impacts.



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answer is both easy and obvious. If the UK system is built on soft law, enforced by an extra judicial Panel, whilst the US relies upon hard law enforced by the courts, then those fundamental structural/institutional arrangements will cause, and explain, whatever litigation practices we discover in the UK and the US. As is often the case, however, what may appear as obvious is merely partly true. A full explanation is more complex, and much more intriguing.

The third issue that shall be addressed is to *evaluate* the different litigation landscapes that have been described and explained. It answers the question: so what? Why is it important to understand whether the US and the UK experience remarkably different levels of litigation during takeovers, or care what the causes of these differences may be?

To summarise, there are three principal research questions that this thesis seeks to answer:

a) What takeover litigation is undertaken in the UK, and the US?

b) How can we explain the divergence in the propensity to litigate between these two regimes?

c) Why do the different propensities to litigate matter?

**1.2 Thesis Outline**

Chapter two provides a context for the discussion that follows. It does so by explaining why takeovers themselves matter (and why therefore the reader might think a further contribution to the takeover literature is worthwhile). Despite their technicality, takeovers have a significant impact upon the lives of "ordinary" citizens. Yet how they should be regulated remains hugely controversial. Chapter two explores this controversy. It discusses in particular the merits of the market for corporate control ("MCC") by outlining its three main benefits. The first two benefits arise from the promotion of economic efficiency, through the reallocation of resources to their most productive use and through creating stronger disciplinary incentives. The third benefit is the protection that takeovers afford to minority shareholders. This chapter will then examine the main criticisms made against the MCC,



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namely that the market is not efficient enough to allow the MCC to function correctly and that takeovers do not act as a disciplinary device. Finally, this chapter will investigate alternatives to the MCC, focusing specifically on shareholder activism, and finally concluding that the literature indicates that the MCC is a necessary tool in the Anglo-American corporate governance system. Having established this, it is clear that takeovers play an important role in the system of governance and any limitations placed on it, such as frustrating litigation, may not be warranted. Whilst chapter two provides a context within which to understand the need for the MCC, it also provides a basis for the assessment of litigation practices, which will be drawn upon in the final, evaluatory chapter.

In seeking to explain why there is more or less litigation within these jurisdictions the next chapters (chapters three to six) first describe the takeover practices and regulatory regimes within the UK and US, and then examine the types of litigation and the different propensities to litigate. The further chapters (chapters seven and eight) will then build upon this groundwork to explain the different levels of litigation and evaluate the impacts of those levels on the takeover process in both jurisdictions.

Chapter three therefore offers a description of the regulation and process of takeovers in the UK, including discussing the key players within takeovers and their competing interests. The chapter will thus first describe the process by which a takeover is completed in the UK and the players that take part in this process, and then move on to describe the function and role of the Panel and the scope of the Code. This chapter will also identify the relevant company law provisions that impact upon the regulation of takeovers. The aim of the fourth chapter is to establish the level of takeover litigation in the UK. As data was not already available from current literature, an empirical study was undertaken to ascertain the exact levels of litigation within the UK. This chapter also identifies the causes of action that generate litigation in the UK, who instigates litigation, and who is the subject of these claims.

As already established, the regulation and process of takeovers in the US is very different from those in the UK, and as such, the fifth chapter offers a description of the US system. Chapter six then establishes the levels of litigation that parties to a takeover in the US



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undertake during the takeover process. The method for gathering the data ascertaining these levels differs from that in chapter four, which used hand collected data. This chapter will instead use empirical studies that have already been completed in the US, which give sufficient data for this assessment. This chapter unexpectedly reveals that target shareholders are the instigators of the large majority of litigation in the US. More surprising still, the targets of the litigation are their own directors. It is common for the shareholders to allege that their directors have breached their fiduciary duty of disclosure, and use the class action as a means to bring this claim to the courts.

Chapter seven focuses on explaining the difference between the UK and US's different propensities to litigate. The chapter offers four candidates for explaining this: firstly, that greater statutory disclosure obligations are owed by directors in the US; secondly, the class action and the attorney fees that can be recovered in this type of litigation; thirdly the role played by both the Panel and the Code; and finally litigation culture. Finally, chapter eight turns to focus on evaluating the impacts that these differences have on the takeover process: i.e. what effect do the levels of litigation have on the takeover process? The chapter will however limit the impacts discussed to those which significantly affect what generally is sought from the takeover process: speed, not unduly costly, of benefit to target shareholders who bring the litigation and the impact on the MCC.

### 1.3 Methodology

The first stage of the project involved desk-based research to obtain a thorough overview of the literature describing the impact of takeovers in general and the regulation of such takeovers in the UK and US. Relevant sources included academic monographs, journal articles, conference/working/policy papers and reports (see bibliography). These, together with necessary US materials, are available through Durham University's library either physically or electronically (e.g. Westlaw International, Lexis, HeinOnline, LSN, Web of Knowledge, EBSCO). The second stage of the research focused on the three research questions described above, and mainly involved desk-based research. In order to answer the first question, (i.e. what takeover litigation is undertaken in these systems), an empirical study was carried out to ascertain the actual levels of litigation in the UK.



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A search was therefore undertaken in order to find all instances of takeover litigation in the UK. The cases which were of interest involved a takeover by either a scheme of arrangement, takeover offer, or any case in which there was a change of control or threat of a change of control. Both friendly and hostile takeovers were counted, and also claims brought either during or after the takeover. This is to enable a good overview of the litigation which can be brought during the whole of the takeover process including the effects of a takeover. Using the LexisNexis Professional internet database, the search began by initially searching against each cause of action that had been identified as being one which parties to a takeover could use to progress a complaint; for example, s.171 of the Companies Act 2006 ("CA"). Once this search was completed, a case search was undertaken in order to seek out cases under the causes of action which did not have a relevant provision, such as the common law duty of care. Defunct legislation was also searched when there was an identical provision that existed during the time period looked at, for example s.459 of the Companies Act 1985 has now been replaced by s.994 CA.

These case searches however brought up many cases that were not relevant. In order to find those cases which involved takeover litigation, each case was examined individually. In some instances this was not possible to do with the initial search term (which was the cause of action). Therefore some searches were refined by selecting the company law field, and then searching within the results using the term "takeover." Once the whole search was complete, each case that had been found was then examined further using the case history function. This function allows the cases which had referred to the judgment of the relevant case to be shown, and also the cases which the relevant case had used in its judgment. Each relevant case was then checked to ensure that all the pertinent cases had been found. A more detailed outline of the study is given in chapter four along with the findings of the search.

In explaining the divergence in litigation practices a detailed investigation of the development of case law, forms of action and practices within the two jurisdictions was undertaken, and the broader cultural attitudes towards litigation within the two were also examined. Next, the project explored the consequences of the different levels of litigation. The research drew on



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the existing literature, from a number of disciplines, debating the impacts of takeovers in general, but seeking to isolate the specific effects of litigation within the takeover process.

Relevant participants within these takeover disputes, including five M&A partners at top tier London law firms, were interviewed to ascertain their views as to their experience of takeover litigation and opinions as to why they believed there was a divergence in litigation practices during takeovers. Finally, the regulatory implications of the findings were analysed. For this final part, a relevant policy maker, the deputy director of the Panel, was interviewed.



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## Chapter Two

## The Theory of the Market for Corporate Control

### 2.1 Introduction

This first chapter will reveal why takeovers are important, by establishing that takeovers play an important role in the system of governance. They perform this governance role via the market for corporate control ("MCC") whereby takeovers not only act as a tool to make companies more efficient but also discipline poor management. Any litigation that takes place during a takeover which frustrates the bid and prevents it from completing will impact upon the effectiveness of this governance mechanism. This is because the MCC relies upon takeovers occurring frequently and unhindered. Whilst this first chapter provides a context within which to understand the need for the MCC, it also provides a basis for the assessment of litigation practices, which will be drawn upon in the final, evaluatory chapter.

The fundamental premise underlying the MCC is the existence of a high positive correlation between corporate managerial efficiency and the market price of shares of that company.[3] The lower the stock price, relative to what it could be with more efficient management, the more attractive a takeover becomes to those who believe that they can manage the company more efficiently.[4] There is general agreement that the motives for a takeover determine its character, for instance it is said that hostile takeovers will take on a disciplinary nature whilst synergistic takeovers are more likely to be friendly.[5]

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[3] Henry Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110, 112

[4] ibid 113

[5] Randall Morck, Andrei Shleifer, Robert Vishny, 'Characteristics of targets of hostile and friendly takeovers' in Alan J. Auerbach (ed), *Corporate Takeovers: Causes and Consequences* (National Bureau of Economic Research, Chicago)



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The view that hostile takeovers function as a corporate governance mechanism is often used to explain the trend of de-conglomeration during the 1980s. Some academics subsequently argued that the hostile takeover emerged in the 1980s as a response to the wave of mergers and acquisitions in the 1960s, which produced a high number of inefficient conglomerates.[6] When companies 'failed to recognise the flawed nature of their diversification strategies, or were not fast enough to refocus their operations, hostile raiders were ready to do the restructuring job for them.'[7] It is consequently thought that the top executives are more likely to be removed from office in those targets which are performing worse than the average firm in their industry.[8]

Takeovers are therefore an important method of correcting managerial failure, and as such, an effective external corporate governance mechanism.[9] Rappaport, for example, believes that the wave of takeover activity in the late 1980's has changed the attitudes and practices of US managers.[10] He argues that 'it represents the most effective check on management autonomy ever devised.'[11] The critics of the MCC, however, see takeovers as a poor form of corporate governance and maintain that they are exceedingly bad for the economy.

Taking these mixed attitudes into consideration, this chapter aims to do three things: firstly to illustrate the merits of the MCC; secondly to discuss the main criticisms of this mechanism; and thirdly to explain that there is no viable alternative currently available to replace the MCC, at least within the corporate governance regime of the UK. Section 2.2 will outline the three main benefits of the MCC: the first two arise from the promotion of economic efficiency, firstly through the reallocation of resources to their most productive use, and secondly through creating stronger disciplinary incentives. The third benefit is the protection

[6] See Amar Bhide, 'Reversing corporate diversification' (1990) 3 Journal of Applied Corporate Finance 70, Andrei Shleifer, Robert Vishny, 'Takeovers in the '60s and the '80s: evidence and implications' (1991) 12 Strategic Management Journal 51

[7] Marina Martynova, Luc Renneboog, 'A century of corporate takeovers: What have we learned and where do we stand?' (2008) 32 Journal of Banking & Finance 2148, 2173

[8] Kenneth Martin, John McConnell, 'Corporate Performance, Corporate Takeovers, and Management Turnover' (1991) 46 The Journal of Finance 671, 681

[9] Julian Franks, Colin Mayer, 'Hostile takeovers and the correction of managerial failure' (1996) 40 Journal of Financial Economics 163

[10] Alfred Rappaport, 'The staying power of the public corporation' (1990) 68 Harvard Business Review 96

[11] ibid 100



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that takeovers afford to minority shareholders. Section 2.3 will then examine the main criticisms made against the MCC, namely that the market is not efficient enough to allow the MCC to function correctly and that takeovers do not act as a disciplinary device. Section 2.4 will investigate alternatives to the MCC, focusing specifically on shareholder activism, and finally concluding that the literature indicates that the MCC is a necessary tool in the Anglo-American corporate governance system.

## 2.2 The Merits of the Market for Corporate Control

A great deal of theory and evidence supports the idea that takeovers address governance problems,[12] and that a well-functioning takeover market is essential to overall economic prosperity.[13] An active market for corporate control is said to benefit the economy in three main ways: by creating greater economic efficiency; disciplining poor management; and protecting minority shareholders. These will now be discussed in turn.

### 2.2.1 Economic Efficiency

Economic efficiency is a broad term that implies an economic state in which every resource is optimally allocated while minimising waste and inefficiency.[14] A well-functioning MCC creates economic efficiency by allowing outside parties to takeover poorly performing companies.[15] Economic efficiency consequently occurs because of the change in control to more effective management, who can then improve the value of the company's existing resources and create allocational efficiency through the reallocation of resources to their most productive and efficient use.

Poor management, biases in managers' decisions or managerial rent-seeking behaviours can have a vast impact upon the productivity of a company. This is because managers are

[12] Andrei Shleifer, Robert Vishny, 'A Survey of Corporate Governance' (1997) 52 The Journal of Finance 737, see also Michael Jensen, 'Takeovers: their causes and consequences' (1988) 2 The Journal of Economic Perspectives 21, David Scharfstein, 'The Disciplinary Role of Takeovers' (1988) 55 The Review of Economic Studies 185
[13] Elaine Hutson, 'Australia's takeover rules: how good are they?' (2002) 4 Financial Services Institute of Australasia 33, 33
[14] Investopedia <http://www.investopedia.com/terms/e/economic_efficiency.asp> accessed 26 April 2014
[15] Mike Burkart, 'The economics of takeover regulation' (1999) SITE Staff Paper 99.06, 4



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important to corporate decision making due to their expertise and the information they acquire about the firm and its prospects.[16] If a company is not productive, it will become inefficient. Bertrand and Mullainathan, found that poor managers avoided costly efforts associated with shutting down of old plants or starting new plants; and that they paid higher wages in order to buy peace with their workers.[17] They maintain that poor management may prefer to avoid the difficult decisions in order to lead a "quiet life."[18] Jensen's free cash flow theory also hypothesised that poor management were inclined to sacrifice a company's profitability for size by investing in unprofitable projects.[19] Takeovers can therefore help to remedy incumbent management's over-investment of resources by bringing in new managers who can effectively eliminate excess capacities, reduce wasteful investments, superfluous wages or reverse previous unprofitable acquisitions.[20]

New management can also improve the value of existing corporate resources by exploiting synergies from combining the target and bidder firms, resulting in improved performance and productivity.[21] The Australian Takeover Panel reported that takeovers can additionally assist allocative efficiency by facilitating the reallocation of capital between industries.[22] They argued that many managers are often reluctant to invest outside their own or closely-related industries, even though returns may be substantially higher elsewhere. This, they argued, is because managers' skills and experience are often highly industry-specific.[23] Takeover 'specialists often have less attachment to a particular industry and are more willing to invest in alternative, potentially higher-yielding activities.'[24] In this context, they concluded, firms

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[16] Aaron Edlin, Joseph Stiglitz, 'Discouraging Rivals: Managerial Rent-Seeking and Economic Inefficiencies' (1995) 85 The American Economic Review 1301, 1301

[17] See Marianne Bertrand, Sendhil Mullainathan, 'Enjoying the quite life? Corporate governance and managerial preferences' (2003) 111 Journal of Political Economy 1043; see also Marianne Bertrand, Sendhil Mullainathan, 'Is there discretion in wage setting? A test using takeover legislation' (1999) 30 Rand Journal of Economics 535

[18] ibid

[19] Michael Jensen, 'Agency costs of free cash flow, corporate finance, and takeovers' (1986) 76 The American Economic Review 323

[20] Burkart (n15), 6

[21] ibid, see also Vojislav Maksimovic, Gordon Phillips, 'The market for corporate assets: who engages in mergers and asset sales and are there efficiency gains?' (2001) 56 The Journal of Finance 2019

[22] Treasury Economic Paper, 'Some Economic Implications of Takeovers' (1986) Australian Government, Paper 12, 8 <http://www.takeovers.gov.au/content/Resources/other_resources/Economic_Implications.aspx> accessed 10 April 2014

[23] ibid

[24] ibid



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with large cash flows operating in industries with poor to average prospects are particularly likely to be hostile takeover targets.[25]

Efficiency gains from takeovers also hugely benefit target shareholders both pre and post takeover.[26] Before and after the initial announcement of the tender offer target shareholders see a large, positive, abnormal return on their investment.[27] This happens because the worth of the target company is estimated to increase post-takeover[28] due to the expected efficiency gains. Loughran and Vijh,[29] and Franks et al[30] show that due to operational changes, targets of hostile takeovers in the UK significantly, outperform friendly takeover targets over a three year window following the bid announcement.[31] Jensen, for instance, estimated that post takeover restructurings of Phillips, Unocal and Arco in the 1980's created total gains for shareholders of $6.6 billion, due to a reduction in investment in negative net present value projects.[32] The MCC thus subjects firms to a 'continuous auction process which ensures that resources flow to their highest value use.'[33]

### 2.2.2 Disciplinary Device

The threat of a change in control acts as a disciplinary mechanism because inefficient or wasteful managers run a high risk of being dismissed. Armour and Skeel explain that a properly functioning takeover market can discipline management by keeping them on their toes: '[I]f managers have reason to suspect that a hostile bidder will swoop in and take

[25] Treasury Economic Paper (n22)
[26] Martynova, Renneboog (n7), 2153
[27] see Sandra Betton, Espen Eckbo, 'State-contingent Payoffs in Takeovers: New Structural Estimates' (1997) Stockholm School of Economics; William Schwert, 'Markup Pricing in Mergers and Acquisition' (1996) 41 Journal of Financial Economics 153; Rene Stulz, Ralph Walkling, Moon Song, 'The Distribution of Target Ownership and the Division of Gains in Successful Takeovers' (1990) 45 Journal of Finance 817; Richard Ruback, Michael Jensen, 'The Market for Corporate Control: The Scientific Evidence' (1983) 11 Journal of Financial Economics 5
[28] ibid 22
[29] Tim Loughran, Anand M Vijh, 'Do long-term shareholders benefit from corporate acquisitions?' (1997) 52 Journal of Finance 1765
[30] Julian Franks, Robert Harris, Sheridan Titman, 'The post-merger share-price performance of acquiring firms' (1991) 29 Journal of Financial Economics 81
[31] Martynova, Renneboog (n7) 2164
[32] Jensen (n19), Gregg Jarrell, James Brickley, Jeffry M. Netter, 'The Market for Corporate Control: The Empirical Evidence Since 1980' (1988) 2 The Journal of Economic Perspectives 49, 50
[33] Burkart (n15)



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control.'[34] The discipline of management does not therefore depend on takeovers actually occurring. 'The mere threat of a takeover may galvanise the existing management of a target company into improving its performance and raising the returns obtained on assets' to reduce the risk of a further takeover bid.'[35]

When underperforming firms are likely targets of hostile offers, management are more motivated to achieve efficiency.[36] Shleifer and Vishny, for example, demonstrated that the pressures of possible hostile takeovers affected how management behaved, inducing them to restructure and increase value creation.[37] Nuttall also completed a study which confirmed that the threat of a hostile takeover had a disciplinary effect on management who were forced to rethink their current strategies.[38] Moreover Bertrand and Mullainathan, who assessed the effects of different anti-takeover legislation used in the US, found that restrictions put in place within takeover markets had a real effect on firm behaviour and generated a rise in poor management.[39]

An active hostile takeover market is thus arguably necessary to motivate management to be effective, and it's not just those companies which are potential targets that are affected. Takeover related changes in the operating strategy of a target firm also often lead to similar changes in rival firms.[40] Kerschbamer found that not only did the stock prices of targets, but also those of other firms in the same industry, increased strongly around the date of a takeover bid.[41] He argued that if an industry settles into an "inefficient incentive equilibrium," then a hostile takeover that provides new incentives for the management of a single company in the industry, induces the whole industry to move from an "inefficient

[34] Armour John, Skeel David, 'Who writes the rules for hostile takeovers and why? – The peculiar divergence of US and UK takeover regulation' (2007) 95 Georgetown Law Journal 1727, 1733
[35] (n22) 1, see also Sayan Chatterjee, Jeffrey Harrison, Donald Bergh, 'Failed Takeover Attempts, Corporate Governance and Refocusing' (2003) 24 Strategic Management Journal 87, 94
[36] Ralph Scholten, 'Investment Decisions and Managerial Discipline: Evidence from the Takeover Market' (2005) Financial Management 35, 35
[37] Andrei Shleifer, Robert Vishny, 'The Efficiency of Investment in the Presence of Aggregate Demand Spillovers' (1988) 96 Journal of Political Economy 1221
[38] Robert Nuttall, 'An Empirical Analysis of the Effects of the Threat of Takeover on UK Company Performance' (1999) Economics Series Working Papers W05 University of Oxford, Department of Economics
[39] Marianne Bertrand, Sendhil Mullainathan, 'Enjoying the Quiet Life? Corporate Governance and Managerial Preferences' (2003) 111 Journal of Political Economy 1043
[40] Rudolf Kerschbamer, 'Disciplinary Takeovers and Industry Effects' (1998) 7 Journal of Economics & Management Strategy 265
[41] ibid



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contracting equilibrium to an efficient one."[42] A single disciplinary takeover, or even the threat of one, can accordingly change the incentives and behaviour for all managers in the industry.

### 2.2.3 Minority Shareholder Protection

Takeovers, as well as acting as a mechanism for efficiency and discipline, have an emphasis on the protection of minority shareholders.[43] This is particularly true in the UK as the Code aims to 'ensure that shareholders in [a target] company are treated fairly and are not denied an opportunity to decide on the merits of a takeover.'[44] Takeover regulation in the UK therefore requires directors to seek shareholders' approval in a general meeting before adopting measures or actions that may frustrate a takeover bid.[45]

The UK concepts of "squeeze-out" and "sell-out," for example, are also designed to address the problems of residual minority shareholders following a successful takeover bid.[46] Squeeze-out rights enable a successful bidder to compulsorily purchase the shares of the remaining minority shareholders who have not accepted the bid.[47] Whilst sell-out rights enable minority shareholders, in the wake of such a bid, to require the majority shareholder to purchase their shares: the sell-out rules therefore give the rump shareholders the right not only to exit the company, rather than to remain as minority shareholders, but crucially to be able to be bought out at the offer price.[48]

This minority protection plays an important role in preserving the integrity of capital markets by enhancing the willingness of small shareholders to invest in equity. Without minority protection there may be 'insufficient interest in equity investment, resulting in depressed

[42] Kerschbamer (n40) 295
[43] Hutson (n13) 34
[44] The Takeover Code, para 2(a)
[45] Jonathan Mukwiri, 'Takeovers and incidental protection of minority shareholders' (2013) 10 European Company and Financial Law Review 432
[46] Explanatory Notes to the Companies Act 2006, para 1242
[47] Companies Act 2006, s.979
[48] Jennifer Payne, 'Minority shareholder protection in takeovers: A UK perspective' (2011) 8 European Company and Financial Law Review 145, 148



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share prices and a suboptimal allocation of resources.'[49] The MCC consequently gives to shareholders both power and protection commensurate with their interest in corporate affairs[50] and is a key mechanism for rendering managers accountable to shareholders.[51] The MCC is arguably the most effective protection for shareholders to facilitate the exercise of their rights in a dispersed ownership market system.

The MCC therefore plays an important role both within capital markets, and also as a corporate governance mechanism. The economic efficiency created from hostile takeovers means that companies are putting their assets to best use and as a result generates an efficient economy. An active takeover market also works as a corporate governance mechanism in which continual checks are placed on management, disciplining those who are poor decision makers and motivating others to keep maximising company value to avoid becoming a target. Minority shareholder protection afforded by their options to exit on fair terms means that they are encouraged to keep on investing, which is imperative in dispersed markets such as the UK and US. Critics however argue that the effectiveness of the MCC as an external control mechanism relies too heavily upon a number of assumptions which are not attainable.

### 2.3 Criticisms of the Market for Corporate Control

Despite the benefits that arise from the MCC, critics maintain that it is flawed. The main arguments put forward are firstly, that the MCC relies on an ideal market which is not attainable, and secondly that the MCC does not act as a disciplinary device. Section 2.3.1 of this chapter will focus on discussing these two main criticisms.

#### 2.3.1 The Ideal Market and Stock Market Efficiency

The ideal market is one in which stock prices provide accurate signals for investors to buy or sell shares. Investors participating in the ideal market can choose amongst shares that represent the ownership of the company's activities under the clear assumption that the

[49] Hutson (n13) 34
[50] Manne (n3) 112
[51] Armour, Skeel (n34) 1728



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process at any time fully reflects all available information.[52] When prices always fully reflect available information the market is "efficient." In an efficient market, production-investment decisions can be made easily and accurately.[53] This is known as the efficient market hypothesis and is the corner stone of modern financial theories.

The MCC, and the benefits that arise from it, are therefore conditional upon an efficient market accurately pricing shares. This is because accurate pricing is necessary to identify bad management, rather than good managers who might make disagreeable decisions, and to identify those companies which are performing poorly and have the potential to improve. If the market is efficient it will be able to distinguish between those managers and companies who are continually poor performers and those who have, for example made one bad judgement or a company effected by the outside environment. It should do this by pricing the shares of those consistently poor companies much lower than the industry average. The market can also generally establish the difference between companies who are not performing well due to problems with efficiency and those who are not paying high dividends to shareholders due to long-term strategies, such as investing in research and development. Accurate share pricing is therefore imperative in determining the correct targets, which need to be improved.

Accurate share pricing is also important in terms of identifying appropriate bidders. If a bidder's shares have been overvalued for example, then the bidder will not be in a position to take over a target firm and increase efficiency. However, if shares are priced accurately it will be more likely that the bidders are well managed companies. This is because they will have a high share price relative to the market. This will enable them to either generate enough cash to pay for the targets shares outright or pay for the bid using their own shares. Bidders are therefore more highly valued relative to their targets. High quality bidders are necessary in order to be able to improve targets. Accurate share pricing is therefore imperative to assist in confirming a bidder's position to take over another company, and in identifying the correct

[52] Eugene Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 The Journal of Finance 383, 383
[53] ibid



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targets for the takeover. If the share price of either a target or a bidder is miscalculated the benefits of the MCC cannot be acquired.

Critics of MCC however argue that stock markets are far from ideal, and their efficiency relies on a number of assumptions that are not attainable. These assumptions are (1) that all information is fully available and is properly reflected in the share price, and (2) that investors are rational enough to assess this information correctly. Critics argue that these assumptions required for an efficient market are not realistic, that real markets are both volatile and uncontrollable. This section will therefore discuss and critique these two components that are said to make up an efficient market.

2.3.1.1 Available Information

The efficient market theory relies on an even flow of new and accurate information through to the market in order to accurately assess the price of shares.[54] Economic empirical work in this area has focused on three main research themes in order to assess whether prices fully reflect available information. These themes focus on different subsets of information: firstly what is known as weak form tests in which studies focus on past price histories and other variables; semi-strong form tests which are concerned with the speed of price adjustments to other obviously publicly available information; and finally strong form tests which assess whether monopolistic access to any relevant information affects the accuracy of pricing.[55] These tests are undertaken in order to assess whether the market can be beaten, for example if there is information available that an investor can use to buy stocks which have been undervalued by the market. The research is however also particularly useful in assessing whether the market is efficient enough for the MCC to function as a corporate governance mechanism. This is because the more accurate the pricing the more efficient the market will be, and therefore the more effective the MCC will be.

[54] Blanaid Clarke, 'Where was the 'Market for Corporate Control' when we Needed it?' (2009) UCD Working Papers in Law, Criminology & Socio-Legal Studies Research Paper 23/2009 <http://ssrn.com/abstract=1524785> accessed 19 October 2013

[55] Eugene Fama, 'Efficient Capital Markets: II' (1991) 46 The Journal of Finance 1575



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The research in to weak form tests, or return predictability, is vast and growing, and therefore only a brief summary of the evidence will be discussed here. Return predictability studies have shown that daily and weekly returns can be predicted from past returns.[56] Research has also demonstrated that returns for short and long horizons are predictable from dividend yields, E/P ratios, and default spreads of low-over high-grade bond yields.[57] The predictability of stock returns is not in itself evidence for or against market efficiency, however there is some controversy surrounding the variation in expected returns discovered within these tests.[58] The market may therefore be prone to variation due to current versus future consumption or by technology shocks. This could mean that the market is vulnerable to "bubbles" because shares prices are not correctly valued. If this is true then the MCC cannot properly function. The research in this area is however on-going and the reasons for the variations and their effects on the efficient market is a contentious issue. There is also however no definitive evidence yet as to whether these "bubbles" mean that markets are or are not efficient.[59]

Semi-strong form tests or event studies, on the other hand strongly indicate that the market is efficient.[60] This is because event studies can give a clear picture of the speed of adjustment of prices to information. There is a large amount of literature that illustrates how average stock prices adjust quickly to information, such as information about investment decisions, dividend changes, changes in capital structure, and corporate-control transactions.[61] Fama notes that:

[56] See Lawrence Fisher, 'Some new stock-market indexes' (1966) 39 Journal of Business 191, Andrew Lo, Craig MacKinlay, 'Stock market prices do not follow random walks: Evidence from a simple specification test' (1988)1 Review of Financial Studies 41, Jennifer Conrad, Gautam Kaul, 'Time-variation in expected returns' (1988) 61 Journal of Business 409

[57] See Donald Keim, Robert Stambaugh, 'Predicting returns in the stock and bond markets' (1986) 17 Journal of Financial Economics 357, John Campbell, Robert Shiller, 'Stock prices, earnings and expected dividends' (1988b) 43 Journal of Finance 661, Eugene Fama, Kenneth French, 'Business conditions and expected returns on stocks and bonds' (1989) 25 Journal of Financial Economics 23

[58] Fama (n55) 1583

[59] See current debates between Eugene Fama and Shiller, who have both been awarded Nobel prizes in 2014 for contrasting research

[60] Fama (n55) 1607

[61] Stephen Brown, Jerold B. Warner, 'Using daily stock returns: The case of event studies' (1985)14 Journal of Financial Economics 3, Paul Asquith, 'Merger bids, uncertainty and stock holder returns' (1983) 11 Journal of Financial Economics 51, Ronald Masulis, Ashok Korwar, 'Seasoned equity offerings: an empirical investigation' (1986) 15 Journal of Financial Economics 91, Larry Dann, 'Common stock repurchases: An analysis of returns to bondholders and stockholders' (1981) 9 Journal of Financial Economics 113, Theo Vermaelen, 'Common stock repurchases and market signalling: An empirical study' (1989) 9 Journal of Financial Economics 139



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*'The typical result in event studies on daily data is that, on average, stock prices seem to adjust within a day to event announcements. The result is so common that this work now devotes little space to market efficiency. The fact that quick adjustment is consistent with efficiency is noted, and then the studies move on to other issues.'*[62]

Strong form tests, or tests for private information, have demonstrated that some individuals do have private information which is not reflected in share prices. For example, the profitability of insider trading has been established in detail, and there is some evidence that security analysts do possess information not reflected in stock price.[63] Some studies within this area also claim to have evidence to support professional investment managers having access to private information,[64] but the evidence on balance suggests that they do not.[65] The conclusion from this area of work subsequently seems to be that whilst there are some individuals that have private information, it is not on a large enough scale to affect the relative efficiency of the market.[66]

Critics however maintain that there is clear evidence from the recent financial crisis of relevant information, for example in relation to risk management, not being made available either to boards or to the public.[67] The high profile collapse of US corporate giant Enron, followed closely by WorldCom, also occurred because both companies had massively overstated their profits.[68] Critics argue that the share price of banks undertaking high risk strategies during the financial crisis should have decreased to reflect managerial behaviour. It appears self-evident now, however that the management of banks before the crash did not perform effectively, and that bank CDS (credit default swap) prices did not provide forewarning of the scale of the problems ahead.[69] The Turner Review revealed that bank

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[62] Fama (n55) 1601
[63] ibid 1608
[64] See Richard Ippolito, 'Efficiency with costly information: A study of mutual fund performance' (1989) 104 Quarterly Journal of Economics 1
[65] Fama (n55) 1603, see also Gary Brinson, Randolph Hood, Gilbert Beebower, ' Determinants of portfolio performance' (1986) 43 Financial Analysts Journal **39**
[66] Fama (n55) 1608
[67] Clarke (n54) 4
[68] 'Sarbanes Oxley Act 2002 (SOX IT Compliance)' (E Radar, Smarter Business Online) < http://www.eradar.eu/sox-it-compliance/> accessed 21 January 2014
[69] The Turner Review, 'A regulatory response to the global banking crisis' (Financial Services Authority, 2009) 46



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share prices failed to indicate that risks were increasing, but instead delivered strong market price reinforcement to management's convictions that their aggressive growth strategies were value creative.[70] It is thus argued that if the MCC functioned effectively share prices would have reflected these failures and the companies would have become the target of a takeover; after which the benefits of allocational efficiency, managerial discipline and minority shareholder protection would have kicked in.

Critics contend that when relevant information is not made available to investors, they lose their powers of control to either voice their concern or sell their shares out of protest. The lack of information also means that the share price will not reflect how the company is ran, and thus impacts on the effectiveness of the MCC and its benefits. In reality, however there will always be anomalies in the market, but they are relatively infrequent and it does not mean that it is a reflective failure of available information delivering accurate share pricing on a day to day basis. The Turner review confirmed that whilst market overshoots may happen, a balance still needs to be struck to allow liquid markets to work. These overshoots in share pricing are however being combatted by the use of tighter regulation and improvements in technology. For instance, in the UK listed companies are required to comply with the Disclosure and Transparency Rules, which necessitates companies to have appropriate internal procedures in place regarding the timely and accurate disclosure of information to the market.[71] It requires the disclosure of information that would have a significant effect on the price of the qualifying investments or on the price of related investments.[72]

What is considered significant depends on an assessment of the company, who are required to take into consideration the anticipated impact of the information in light of the totality of their activities. If the disclosure rules are not complied with then the Financial Conduct Authority ("FCA") can suspend trading.[73] In the US the Sarbanes-Oxley Act[74] also requires

[70] Turner Review (n69)
[71] Disclosure and Transparency Rules (DTR) <http://fshandbook.info/FS/html/handbook/DTR> accessed 21 January 2014
[72] ibid para 2
[73] ibid para 1.4
[74] Sarbanes Oxley Act 2002



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real-time disclosures on material events,[75] and the Securities and Exchange Commission has backed this requirement by mandating immediate online reporting of all material information.[76] These transparency and disclosure requirements ensure that companies are aware of what information needs to be available and that non-compliance has serious consequences. These requirements safeguard market efficiency by creating accurate share pricing in which the market is able to rely upon.

The efficiency of the market has also been improved through technology, for example by using online disclosures companies have increased the frequency of available information. Studies have established that timelier material disclosures are price informative,[77] and that investors benefit from online disclosures as they reduce the cost of information processing and procurement.[78] Prior theoretical and empirical disclosure studies also demonstrate that the frequency of online announcements of material information, as corporate events occur or unfold,[79] speeds up the price formation process and enhances liquidity.[80] Since material information becomes available on a timelier and more frequent basis, frequency also reduces market risk to stocks arising from information asymmetry and increases stock market activity.[81] Corporate information on stock exchange websites is easily accessible, which lowers information search costs for investors. This helps investors conduct appropriate research on the companies in which they wish to invest.

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[75] Sarbanes Oxley Act (n74) s.302

[76] Securities and Exchange Commission, Disclosure of Order Execution and Routing Practices, 17 CFR Part 240 [Release No. 34-43590; File No. S7-16-00] Rule 11Ac1-5, 11Ac1-6

[77] See Robert E Hoskin, John S Hughes, William E Ricks, 'Evidence on the incremental information content of additional firm disclosures made concurrently with earnings' (1986) 24 Journal of Accounting Research 1; Mary Ellen Carter, Billy S Soo, 'The Relevance of Form 8-K Reports' (1999) 37 Journal of Accounting Research 1; Jennifer Francis, Katherine Schipper, Linda Vincent, 'Expanded Disclosures and the Increased Usefulness of Earnings Announcements' (2002) 77 The Accounting Review 515

[78] Asheq Rahman, Roger Debreceny, 'Frequency of Corporate Announcements via Stock Exchange Web Sites and Market Efficiency' (2010) 25 Journal of Accounting, Auditing and Finance 457, 458, see also Alfred Wagenhofer, 'Economic Consequences of Internet Financial Reporting' (2003) 55 Schmalenbach Business Review 262

[79] See International Accounting Standards Committee, 'Business Reporting on the Internet' (1999), Financial Accounting Standards Board, 'Business Reporting Research Project: Electronic Distribution of Business Information' (2000), R Debreceny, G Gray, A Rahman, 'The Determinants of Internet Financial Reporting' (2002) 21 Journal of Accounting and Public Policy 371

[80] Rahman, Debreceny (n78) 459

[81] ibid



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It is consequently arguable that whilst the market is not ideal, the market does price shares accurately enough in practice. Changes to regulations since the crash have meant that companies are compelled to make relevant information available, and due to advancements in technology information is easier and quicker to supply and access. These changes do not create an ideal market, but a practically efficient market. Yet critics also argue that even in an efficient market independently acting market participants are in general not rational in their assessment of the available information, which could mean that the MCC still cannot function correctly.

2.3.1.2 The Rational Investor

There is an assumption that investors will sell shares when they become unhappy with the performance of the company; critics of MCC however argue that investors may not appreciate the inefficiencies involved and may therefore not attribute poor performance to their directors' inefficiencies.[82] It is argued that shareholders simply cannot distinguish between low corporate value caused by mismanagement or by unfavourable environment.[83] For example during the financial crisis the MCC failed to intervene as an external control mechanism. This is because shareholders may have been unaware of the underperformance of the banks and consequently did not attribute this to their board's inefficiencies. For Manne, sales by dissatisfied shareholders are necessary to trigger the MCC.[84] As share prices increased, "shareholders were very satisfied indeed."[85] Whilst the risks management were taking in banks during the financial crisis amounted to, (as we now know in hindsight), poor decision making, it did not trigger the MCC to correct management's behaviour.

It is argued by Shiller, who specialises in behavioural finance, that human error has a great impact on the rationality of investors. As commented by Klarman:

*'[T]he reason that capital markets are, have always been, and will always be inefficient is not because of a shortage of timely information, the lack of analytical tools, or*

[82] Paul Ali, Greg Gregoriou, International Corporate Governance After Sarbanes-Oxley (John Wiley & Sons, 2011)
[83] ibid; see also (n12); Scharfstein (n12) 186
[84] Manne (n3) 113
[85] Clarke (n54) 9



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*inadequate capital. The Internet will not make the market efficient, even though it makes far more information available at everyone's fingertips, faster than ever before. Markets are inefficient because of human nature—innate, deep-rooted, and permanent. People do not consciously choose to invest according to their emotions—they simply cannot help it.'*[86]

Shiller showed that fluctuations in the stock market were consistent with fads and euphoria and had little to do with the fundamental factors that determine the price of an asset.[87] Consequently if the available information does not lead to rational investment decisions by shareholders the market is still not efficient. The irrational assessment of information could affect the realisation of the benefits of the MCC because, as with the financial crisis, poorly ran companies would not become targets and instead carry on performing poorly. A possible rationalisation for the failure to assess the risks, however, is that even if the practices were regarded as risky, they may not have been considered as detrimental to the company, and thus may not have impacted share price and subsequently the shareholders evaluation of the risk.[88] Another possibility is that the banks were just too big to be a target of a hostile takeover. The Turner Review suggested that a reasonable conclusion is that the MCC cannot be expected to play a major role in constraining bank risk taking, and that the primary constraint needs to come from regulation and supervision.[89] The only problem here is that internal governance (investors) also failed. Perhaps then the real problem was underestimating the risks being taken, which in future all parties should carefully consider.

Removing the financial crisis out of the equation, looking solely from the target shareholders perspective only narrows the view of how takeovers operate in practice. Provided that the bidder is rational it does not matter if target shareholders are not. Bidders of hostile takeovers tend not to lead by emotion, rather by a cold assessment of what a firm is worth and what it could be worth if ran more efficiently. Fama criticises Shiller's work, stating that even if investors' assessment of information does affect the function of the MCC, he argues that disagreements among investors regarding the implications of given information do not in

[86] Seth A Klarman, 'A Response to Lowenstein's Searching for Rational Investors In a Perfect Storm' (2005) 30 The Journal of Corporation Law 561, 564
[87] Robert Shiller, 'Do Stock Prices Move Too Much to Be Justified by Subsequent Changes in Dividends?' (1981) 71 The American Economic Review 421
[88] Clarke (n54) 10
[89] Turner Review (n69) 47



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itself imply that the market is inefficient. This is unless there are investors who can 'consistently make better evaluations of available information than are implicit in market prices.'[90] In the Anglo-American market systems where the MCC is more profound, investors are largely institutional. They tend to have greater knowledge and experience which allows them to frequently assess information correctly or at least equally.

It is thus generally agreed that a frictionless market in which all information is freely available and investors agree on its implications is not descriptive of markets met in practice.[91] What can be taken away from the efficient market theory and Fama's work is that markets are mostly efficient.[92] The Turner Review also took this view concluding that:

'*it is quite possible that efficient and liquid markets provide useful and accurate price signals as to the relative attractiveness of different equities or credits even if the overall level of prices is subject to irrational overshoots.*'[93]

These accurate price signals nevertheless allow bidders to identify possible targets in which they can buy-out and create value, utilising the benefits of MCC.

### 2.3.2 The Market for Corporate Control does *not* act as a Disciplinary Device

Franks and Mayer found little evidence that successful hostile takeovers are motivated by poor performance prior to bids.[94] They rationalised that if hostile takeovers perform a disciplinary role, there should be (i) a high level of managerial turnover followed by large-scale restructuring (ii) evidence of anticipated gains associated with the restructurings and poor performance prior to the takeover and (iii) high board turnover to be associated with poor performance of the target prior to the bid. They found that whilst hostile takeovers were indeed associated with a high level of board turnover and restructurings, there was no evidence of poor pre-bid performance and as such board turnover was not associated with

[90] Fama (n52) 388
[91] ibid 387
[92] Shawn Tully, 'What can you learn from Mr. Efficient Markets now?' *Fortune.com* (2013)
[93] Turner Review (n69) 41
[94] Franks, Mayer (n9)



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poor performance.[95] They subsequently concluded the MCC does not function as a disciplinary device for poorly performing management.

A similar study completed by Kini, Kracaw and Mian found no difference in the pre-takeover performance of hostile and friendly targets based on stock price and operating performance measures.[96] They therefore concluded that the higher post-takeover CEO turnover rate associated with hostile targets was not related to past performance.[97] They therefore posited, much like Franks and Mayer, that takeovers did not have a disciplinary effect. They submitted that the higher post-takeover CEO turnover rate for target firms in hostile takeovers may actually only reflect disagreements over the bid price and the future expected performance of the target firm.[98] If takeovers do not perform a disciplinary role then efficiency gains of the MCC cannot be realised because hostile takeovers are not occurring to create value maximisation. This would also mean that MCC was not an effective corporate governance mechanism because it does not provide the much needed checks and balances for management in a dispersed ownership system.

Shivdasani and Schwert however discovered that hostile targets have lower market-to-book ratios than friendly targets.[99] This could indicate that rather than performing poorly at present, hostile targets have a worse predicted future performance than friendly target firms. Morck, Shleifer and Vishny also reported that the targets of hostile takeovers had lower Tobin's-Q ratios,[100] and thus were more undervalued than other Fortune 500 companies they examined.[101] They also suggested that the targets of hostile takeovers are concentrated in low-Q industries.[102] The targets of hostile takeovers, they therefore concluded, are poor

[95] Franks, Mayer (n9) 180
[96] Omesh Kini, William Kracaw, Shehzad Mian, 'The Nature of Discipline by Corporate Takeovers' (2004) 59 The Journal of Finance 1511,
[97] ibid 1549
[98] ibid 1512
[99] Anil Shivdasani, 'Board composition, ownership structure, and hostile takeovers' (1993) 16 Journal of Accounting and Economics 167, G. William Schwert, 'Hostility in Takeovers: In the Eyes of the Beholder?' (2000) 55 The Journal of Finance 2599
[100] Tobin's-Q ratio, is the ratio of the market value of a company's assets (as measured by the market value of its outstanding stock and debt) divided by the replacement cost of the company's assets (book value).
[101] Morck, Shleifer, Vishny (n5) 124, 127
[102] ibid



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performers within poorly performing industries.[103] The targets of friendly takeovers, on the other hand, were indistinguishable in terms of their performance characteristics. These findings are supportive of the disciplinary effect of the MCC.

Martin and McConnell also support this view. When investigating takeovers that occurred over the period 1958 through to 1984 they indicated that, on average, all takeover targets come from industries that are performing well relative to the market, and that the targets of disciplinary takeovers are performing poorly within their industry. On the other hand the targets of non-disciplinary takeovers were performing about as well as the average firm in their industry.[104] Moreover Mork, Shleifer and Vishny found that the targets of hostile bids were usually older, more slowly growing firms that were valued much below the replacement cost of their tangible assets.[105] This indicates that disciplinary takeovers also target firms which have potential for growth that is not being utilised. Disciplinary takeovers therefore do not have to occur solely because of poor performance (in terms of performing badly relative to the whole market), a factor which is the focus of many studies.

This would suggest that how poor performance is actually defined can drastically affect the results of these studies. Martin and McConnell's findings for instance are essentially consistent with Franks and Mayer's, as they too established that there was some evidence that poor performance was being capitalised in the targets of hostile bids when the comparison was made with firms in the same industry, but did not take these findings as supportive evidence of discipline.[106] In stark contrast however Martin and McConnell interpreted the results as indicating that the takeover market did play an important role in disciplining top corporate managers.

These studies also illustrate that the same data can be interpreted in different ways, and how data are compared can also affect the results. Kini et al, for example, compared pre-performance across their whole sample, rather than comparing industry specific findings. In

[103] Martin, McConnell (n5) 120
[104] ibid
[105] ibid 127
[106] Franks, Mayer (n9) 174



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order to capture the disciplinary effect of the takeover, analysis should focus on how the target is performing in their specific industry rather than the market as a whole. This makes sense and ensures that industry specific dips in the market don't bias the results. Kerschbamer,[107] and previously Eckbo,[108] asserted this point, reasoning that industry averages are a better predictor for hostile takeovers than individual company data.

It can, however, be unanimously taken from these studies that there is a high managerial turnover after takeovers. Why exactly this happens is still open for debate, but many studies indicate that the targets of hostile takeovers are performing poorly within their industry and/or have potential for growth which is not being realised. From this it can be argued that takeovers do play a disciplinary role as directors are either removed because they are performing worse than their peers or are not maximising the potential of the company's assets. The MCC therefore seems to perform a disciplinary mechanism which is far reaching and often difficult to measure.

**2.4 Alternative Disciplinary Mechanisms?**

Holmstrom and Kaplan suggest that there has been a fall in hostile takeovers because the MCC is no longer needed as a corporate governance device. This is because there are a sufficient number of alternative governance mechanisms (e.g. stock options, shareholder activism, non-executive director monitoring): and therefore as these mechanisms become more prominent and effective, the takeover market's role will decline.[109] One of the major contenders of the MCC as an alternative mechanism is shareholder activism. Recent academic studies suggest that, by and large, activists are good for companies. An analysis of around 2,000 interventions in the US during 1994-2007 found that the share prices and operating performance of the firms involved improved over the five years after the intervention.[110] High-profile cases also support this research for example: activist investors

[107] Kerschbamer (n40)
[108] B Espen Eckbo, 'Horizontal Merges, Collusion, and Stockholder Wealth' (1983) 11 Journal of Financial Economics 241
[109] Bengt Holmström Steven Kaplan, 'Corporate Governance and Merger Activity in the U.S: Making Sense of the 1980s and 1990s' (2000) MIT Dept. of Economics Working Paper 01/11
[110] 'Corporate upgraders: America should make life easier, not harder, for activist investors' (*The Economist*, Feb 2014) <http://www.economist.com/news/leaders/21596518-america-should-make-life-easier-not-harder-activist-investors-corporate-upgraders> accessed 19 May 2014



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led to new management being brought in at Yahoo, whose share price doubled; and activist investors encouraged the departure of Steve Ballmer from Microsoft, whose share price grew higher than at any time since the dotcom bubble burst.[111]

Shareholder activism has substantially increased over the last decade; for example an article in the financial times revealed that there has been an increase in active investors in US companies from 17 percent in 2010 to 43 percent in 2013.[112] Significant problems however prevent shareholder activism being a viable alternative to the MCC, and the aforementioned survey highlights this issue. This is because the companies used within the data were all valued at over $10 billion or more. It is of course more than worthwhile for a large investor in multi-billion dollar companies to speak up. The same cannot be said however of all investors, particularly minority shareholders and/or those with sizeable portfolios, who tend to have a large number of interests in companies around the world. This is because small shareholders cannot effectively monitor management as well as block-holders (or those with large interests due to monetary value) can due to co-ordination problems.[113] Bolton and von Thadden contend that dispersed owners do not have the same levels of control or incentives to shell out high agency costs.[114] They reason that monitoring by block-holders takes place on an ongoing basis because major investors have strong incentives to monitor management and replace it in poorly performing companies.[115] In systems of dispersed ownership, like the UK and US, shareholders own few shares and exert little internal control within companies (this is particularly exacerbated by the rise in foreign share-ownership), and will subsequently have to rely more heavily on external monitoring via the MCC.[116]

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[111] Corporate Upgraders (n110)
[112] Stephen Foley, 'Shareholder activism: Battle for the boardroom' (*Financial Times*, April 2014) <http://www.ft.com/cms/s/2/a555abec-be32-11e3-961f-00144feabdc0.html#axzz32AyEp5qU> accessed 19 May 2014
[113] Marc Goergen, Marina Martynova, Luc Renneboog, 'Corporate Governance Convergence: Evidence from takeover regulation' (2005) ECGI Law Working Paper N° 33/2005, 6
[114] Patrick Bolton, Ernst-Ludwig Von Thadden, 'Blocks, Liquidity, and Corporate Control' (1998) 53 The Journal of Finance 1
[115] ibid see also Julian Franks, Colin Mayer, Luc Renneboog, 'Who Disciplines Management in Poorly Performing Companies?' (2001) 10 Journal of Financial Intermediation 209
[116] Goergen, Martynova, Renneboog (n113)



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The MCC can also provide minority shareholders with an “exit on fair terms” opportunity.[117] Provisions such as the sell-out right, the mandatory bid rule, or the equal treatment principle, ensure such exit opportunities for these shareholders.[118] This also allows the discipline of management via the MCC, and is considered imperative due to the difficulties in getting minority shareholders involved in decision making. Shareholders with small holdings consequently tend to resort to “exit” strategies rather than “voice” their complaints or engage in activism when problems emerge.

Whilst encouraging shareholders to be actively engaged with decision making within their companies is important, due to the practical difficulties it is not currently a viable alternative to the MCC as a standalone corporate governance mechanism. The need for external control via the MCC therefore becomes ever more vital, as it is pivotal to making dispersed ownership systems viable.[119] Coffee contemplates to this affect, stating that ‘the regime of the takeover is analogous to a political system in which the president could be forced to stand for election at any time’.[120] A well-functioning MCC thus subjects companies to a continuous auction process and ensures that resources flow to their highest value use.[121]

### 2.5 Conclusion

The existing literature indicates that the MCC provides for a broader, more effective and more efficient form of monitoring than any other corporate governance mechanism can currently offer. This is because hostile takeovers create economic efficiency which generates an overall efficient economy, in which management is submitted to continual checks by the market. Minority shareholders are also protected by the MCC as it allows them to easily exit companies when they are underperforming. These benefits are aided by a practically efficient market, in which relevant available information is rationally assessed by the market providing accurate share price signals. The accuracy of the share price consequently helps to identify both rightful bidders and targets.

[117] Goergen, Martynova, Renneboog (n113) 7
[118] ibid
[119] Bertrand, Mullainathan (n39) 1728
[120] John Coffee, ‘The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups’ (1988) Wisconsin Law Review 435, 102
[121] Burkart (n15)



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Whilst there are some valid issues regarding overshoots in the market, the literature indicates that the market is sufficiently efficient to allow MCC to function on a day to day basis. The only real concern and an on-going issue for academia in this area are to understand why these overshoots occur, whether they happen rationally or due to fads and euphoria. This question cannot be answered by this research: but whatever the answer, it is still clear that the MCC is a necessary tool for corporate governance in the Anglo- American market system.



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## Chapter Three

## UK Takeovers: Practices and Regulation

### 3.1 Introduction

Armour and Skeel[122] identified a peculiar divergence between the UK and US when it came to the regulation of takeovers. They posited that given the perceived importance of the market for corporate control and the pivotal role this mechanism is thought to have in making dispersed ownership viable, it was strange, they reflected, that so little attention has been paid to the significant differences in the way in which takeovers are regulated between the two systems that together comprise the Anglo-American model.[123] Both the mode and the substance of the regulation they noted are startlingly different. These differences have also had an impact upon the levels of takeover litigation. In seeking to answer why there is more or less litigation within these jurisdictions the next chapters will first describe the takeover practices and regulatory regime within the UK in this chapter and then secondly, will depict in chapter four the types and propensity to litigate in the UK (and will then do the same for the US). The further chapters (chapters seven and eight) will then build upon this groundwork to explain the propensity to litigate and evaluate the impacts the levels of litigation have on the takeover process in both jurisdictions.

This chapter therefore offers a description of the practices of takeovers in the UK, including a discussion of the key players and their competing interests, and will give an outline of the UK's regulatory regime. Section 3.2 will describe the process by which a takeover is completed. Section 3.3 will then describe the function and role of the Panel on Takeovers and Mergers ("the Panel"), the scope of the Takeover Code ("the Code") and detail the core rules. Section three will look at the relevant company law provisions that impact upon the regulation of takeovers, with a specific focus on directors duties.

[122] Armour, Skeel (n34)
[123] ibid 1728-1729



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### 3.2 Offers and Schemes of Arrangement

A takeover can be structured in two alternative ways: the first being, what is often referred to as a “takeover offer,” or as a “scheme of arrangement.” In a takeover offer a purchaser (“the bidder” or “predator”) will make an offer to the shareholders of the target company to purchase their shares. The offer may be supported by the directors of the target company, in which case it would usually be characterised as a friendly or an agreed takeover. Where the target directors oppose the offer, and refuse to recommend its acceptance to the target’s shareholders, it is labelled as a hostile offer. The primary relationship in the takeover offer is thus one of a contractual nature between the purchasing bidder and the selling target shareholders. Whether the bid succeeds or fails rests upon the total of the individual sale transactions between each shareholder and the bidder. The target company is therefore not directly involved in the transaction, and its board likewise is involved only to the extent that it offers its voice in support of, or in opposition to, the takeover bid.

In contrast to the takeover offer, a scheme of arrangement typically does not involve a bidder making a general offer to each target shareholder individually to purchase their shares. Instead, the bidder’s acquisition of a controlling ownership of the target is achieved through a “scheme.” A bidder will normally approach the target company first to propose a scheme. The target board, on behalf of the company, will then make a proposal about the scheme to the shareholders. The co-operation that is required between the bidder and the target company means that there can never be a “hostile scheme of arrangement,” and that the board of the target company must therefore always agree to the scheme.

A scheme can be completed by the acquisition and transfer of the targets shares to the bidder, in the same way in which a bidder buys the target shares within a takeover offer.[124] The

[124] Due to the tax loop hole created by another method of a takeover scheme (the cancellation scheme) the Government amended the provisions of the CA (Amendment of Part 17) Regulations 2015 (Statutory Instrument 2015/472) in order to prohibit the cancellation scheme of arrangement, whereby a company reduced its share capital as part of a scheme of arrangement. Companies effecting a takeover or merger will need to use a transfer scheme of arrangement or a contractual offer; HM Revenue & Customs, *Guidance Stamp Duty and Stamp Duty Reserve Tax: transfer schemes of arrangement* (November 2015) <https://www.gov.uk/government/publications/stamp-duty-and-stamp-duty-reserve-tax-transfer-schemes-of-arrangement/stamp-duty-and-stamp-duty-reserve-tax-transfer-schemes-of-arrangement> accessed 1 April 2016



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bidder thus achieves control over the target through the acquisition of new shares in the target (rather than by the purchase of the target shareholders' existing shares). The target shareholders will then either receive cash, or shares, in the bidding company, in return for their having agreed to the cancellation of their existing shares.

How takeover offers and schemes of arrangements are completed highlights their core differences. Within a takeover offer there is a "straightforward" sale and purchase of the target shareholders' shares, and at the core of forming a scheme of arrangement there is generally a cancellation of existing shares and the creation and allotment of new ones. Due to these processes the target company, and its directors, are side-parties to the takeover offer. Their involvement however is essential to the completion of a scheme. The directors are required to not only secure the scheme's approval, but to cancel existing shares and to allot new ones. This explains the essence of these two approaches, the next sections will now go on to provide more detail in order to explain the typical moves by which each of these two methods of taking over a company might in practice progress, beginning with the takeover offer.

### 3.2.1 The Process of a Takeover Offer

The purpose of this section, and the next, is to highlight the commercial reality of a takeover bid separately from its regulation. This is in order to explain the essence of what tactical moves different parties to a takeover bid might make, or want to make, and will allow in turn an explanation of the conflicting interests of the parties involved. The parties integral to a takeover bid are generally the bidder, the target directors and the target shareholders. Each will have different goals that they will want to achieve from a takeover offer. For example the target directors may want to prevent the takeover or secure the best price for the company, whereas, bidders will want to succeed in taking over the company, and want to do this by avoiding paying a high premium.



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At the outset, the bidder will form a takeover offer by valuing the shares of the target company. The offer will generally be formed in the medium of cash or shares of the bidding company, or a mix of both. For example, within the Kraft/Cadbury takeover, Kraft's initial offer valued Cadbury's shares at 755 pence each, and was formed as 300 pence in cash and 0.25 in new Kraft shares for each of Cadbury's shares.[125] Although the entire offer consideration sometimes takes the form of shares in the bidding company, it is usual for some or all of the consideration to be in the form of cash.[126] The cash can be made up of the bidder's own resources, but it can also be acquired in whole by underwriting shares in the bidding company.[127] A common method of underwriting is called "cash-underpinning," where the bidder arranges for its own financial advisor to make a separate offer to the shareholders in the target company to acquire shares in the bidder to which they are entitled to as consideration under the offer, such offer being at a fixed price.[128] The bidder can alternatively raise cash funds using some or all of the consideration from a new bank facility using an unconditional loan agreement, which must be in place at the time of the announcement of a formal offer.[129] A loan agreement may however be detrimental to a bidding company due to the typical stipulations of borrowing.

Once a potential bid has been formulated a bidder can approach the target company informally about the possible offer.[130] The bidder can then gauge whether the offer would be welcomed or not. If the target company is favourable to the offer the bidder will be able to carry out due diligence with the co-operation of the target company. Due diligence is common practice in any takeover scenario. It is an investigation that is carried out into the target company usually before a formal offer is made in order to gather information that would be relevant to the sale, and will include a review of the target company's financial records. Due diligence is a way of protecting both parties to the takeover bid from any

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[125] 'Cadbury Kraft Takeover Timeline: How Kraft's £11.5 billion takeover of Cadbury unfolded,' *The Telegraph* (London, 24 May 2011) <http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/8531023/Cadbury-Kraft-takeover-timeline.html> accessed 10 June 2015

[126] A Guide to Takeovers in the UK, Slaughter and May (April 2014) 19 <https://www.slaughterandmay.com/media/39320/a-guide-to-takeovers-in-the-united-kingdom.pdf> accessed 23 August 2014

[127] See David Kershaw, *Principles of Takeover Regulation* (Oxford University Press 2016) 200-201

[128] ibid

[129] A Guide to Takeovers in the UK, Slaughter and May (n126) 19

[130] Louise Gullifer, Jennifer Payne, *Corporate Finance Law* (Hart Publishing 2011) 577



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unnecessary future harm.[131] It is therefore beneficial to the bidder if due diligence can be completed with the help of the target company because the investigation will be more extensive.[132] The extent of the due diligence exercise in a hostile situation would be severely limited as the bidder would only have access to publicly available information, such as the results of searches of public registers and financial analysts reports.[133]

A co-operative target company will however often seek to limit the scope of the investigation to avoid the release of confidential information, particularly if the bidder is a competitor.[134] By limiting the scope of the due diligence the target company protects themselves if a formal offer does not later materialise. The target company may also wish to protect themselves from the bid being leaked to the public, at which point the bidder would have to make a formal offer or withdraw,[135] or to prevent other potential bidders from obtaining information. Consequently, the target company will generally require the bidder to sign a confidentiality agreement, and may also request that the bidder agree to "standstill provisions" that restrict the bidder buying shares in the target company for a specified period of time without the consent of the target board.[136] This will prevent the bidder from stake building, a takeover strategy that is advantageous to the bidder because it makes it easier for any offer to be successful. This is because a stake will give the bidder control, and therefore voting rights, in the target company prior to a formal offer being made.

Whether the target company perceives the potential offer to be hostile or not, they will need to obtain independent advice on that offer, and will make their own opinion known to the target shareholders.[137] The contents of the independent advice received by the target directors and their opinions on the offer are commonly contained in the offeree board circular, in the

[131] A Guide to Takeovers in the UK, Slaughter and May (n126) 19
[132] ibid
[133] ibid
[134] Stephen Cooke, 'You like to-may-to, and I like to-mah-to: 10 things that might surprise a US bidder on a UK takeover' Slaughter and May (2014) 10
[135] See Code Rule 2.2 (c) (a firm announcement of an offer is required by the bidder when the target company becomes subject to rumour and speculation that an offer might be made)
[136] A Guide to Takeovers in the UK, Slaughter and May (n126) 19
[137] Code Rule 3.1 (The board of the offeree company must obtain competent independent advice on any offer); Code Rule 25.2 (The target directors must set out their opinion of the offer in the circular to be given to the target shareholders)



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event of a recommended offer, or in a defence document, if the offer is hostile.[138] The opinion given by directors is one of only a few opportunities in which the target company can try to prevent an unwanted takeover, as they may persuade the target shareholders not to accept the offer. There are many reasons why a director may not want their company taken over by a bidding company (not least that it is likely that they would lose their position). The directors' advice to the shareholders can therefore act as a defence against the takeover.

Takeover defences can either be used before a takeover offer materialises, (these are known as embedded or pre-bid defences), or when a bid is "on the horizon," (these are known as post-bid defences). A target director would ideally use a mixture of the two types of defences. This is because pre-bid defences are designed to make the company look less attractive, and also have the effect of making it more difficult for the bidder to succeed in taking over the company. Post-bid defences, on the other hand, have the ability to frustrate the bid, meaning either the bidder will be defeated or the offer process becomes substantially hampered, usually by causing a substantial time delay that may force the bidder to just walk away.[139] Obviously, the use of defences by the target board is not in the bidders interests. Target shareholders may however benefit from the use of defences because it could potentially increase the premium they receive for their shares, but it can also take away their decision making power. The use of pre-bid defences can prevent unwanted takeovers, but they can also prevent beneficial takeovers. In the UK however it is very difficult to implement pre-bid defences and any post-bid defences are prohibited by the Code.[140] Once the offer has been formalised by the bidder and the bid has been publicly announced the decision of whether the offer is accepted rests solely with the individual target shareholders. The regulation of defences is a complex area of regulation in the UK and will be discussed in more detail in the following sections.

From the time of the initial approach to the completion of the takeover, the bidder must follow a specified timetable set out in the Code. This is in part to protect the target company from the bidder drawing out the takeover process. More time could allow the bidder to

[138] Code Rule 25
[139] See David Kershaw, 'The Illusion of Importance: Reconsidering the UK's Takeover Defence Prohibition' (2007) 56 International and Comparative Law Quarterly 267
[140] See Code Rule 21



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"divide and conquer" the target shareholders. A bidder can adopt this strategy by meeting with different shareholder groups, and persuading them to sell their shares by offering premiums. If a majority of the shareholders is persuaded, then other shareholder groups may feel pressured in to selling their shares to take advantage of any perceived benefits, and to avoid becoming minority shareholders in a company where the bidder has now become a controlling shareholder. In this situation the bidder would want to offer a lower price to the second group of shareholders for their shares; firstly because the shares would likely be worth much less than the original value when the bidder first approached the target, because they would now have a controlling majority and thus other shareholders would not be able to influence the direction of the company; and secondly because the shareholders would be more willing to sell their shares than the initial group because of the first point.

In this scenario the initial group of target shareholders are happy because they were paid a premium for their shares, and the bidder is pleased because they would have taken over the company at a discounted price, in comparison to a fixed offer that had been made to all the target shareholders. This strategy however is not only limited due to the imposed timetable but by other restrictions on the bidder's behaviour during the process of a bid. These restrictions, along with the proposed timetable for bids will be discussed in further detail in the next section. Further time would also however allow the bidder to build up a stake in the company, a strategy which can be accomplished within the confines of takeover regulation. An elongated timetable would additionally mean that a bidder would be able to strike at the most convenient time, perhaps when the target shares are at a low and the bidder could avoid paying premiums for the target shares. This concludes the discussion on the process of the takeover offer. The next section will now describe the process of the other takeover method, the scheme of arrangement.

### 3.2.2 The Process of a Scheme of Arrangement

The process of a scheme of arrangement can be summarised in three steps: the bidder approaches the target directors about the scheme; a meeting of the shareholders is held to vote on the proposal; and thereafter the court will decide whether to approve the scheme. It would be preferable for bidders to use a scheme of arrangement when the takeover is



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recommended by the target board over a takeover offer for a number of reasons. Firstly, unlike a takeover offer, the bidder does not have to deal individually with each shareholder. Instead the scheme will commence when the bidder and the target board agree. In contrast with the offer process, which is led by the bidder, the scheme process is controlled by the target company. Its success therefore depends largely on the co-operation of the target company's board, but this is usually secured by the initial agreement.

Secondly, a scheme will be preferable to an offer to those bidders who want to acquire 100 percent of the target's shares. This may be crucial for a bidder who wants to acquire 100 percent control of the target without minority interests remaining following the takeover. A scheme will achieve this outcome because a successful shareholder vote binds the whole company, even those who voted against the scheme.[141] This consequently means that a scheme will either be agreed by the shareholders or not. This has its advantages for bidders, because if the scheme fails they are not left with a large, possibly even a majority, stake in the target and if it is agreed the bidder will have control of 100 percent of the company.

The bidder, however, may find it more difficult to succeed in a scheme of arrangement than under an offer. This is because a majority number, representing 75 percent of the members must approve the scheme, in contrast to the 50 percent minimum required in an offer.[142] Moreover unlike an offer, the shares already owned by the bidder are not part of the class that is eligible to approve the scheme.[143] In a scheme, once the threshold of 75 percent has been obtained, the bidder acquires all of the shares in the target company.[144] Where the bid is structured as an offer the bidder may only obtain 100 percent of the shares in the target company if more than 90 percent of shareholders accept the offer, enabling the bidder to rely on the "squeeze-out" provisions to buy out the remaining minority shareholders.[145] If less than 90 percent of shareholders accept the offer, the bidder is left with minority shareholders.

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[141] s.899(3) CA 2006
[142] s.899(1) CA 2006
[143] Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press 2014) 128; See for example Re National Bank Ltd [1966] 1 WLR 819; Singer Manufacturing Company v Robinow [1971] SC 11; Re Hellenic & General Trust Ltd [1976] 1 WLR 123
[144] S.899 CA 2006
[145] S.979 CA 2006



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It may however be easier for dissenting shareholders to block a scheme as compared to an offer.[146] The court hearing and shareholders' meeting, which are necessary stages in a scheme, provide the 'ideal forum in which opposition to the bid can be voiced publicly; such opposition may thwart the scheme, either by rousing other shareholders to oppose the deal or by persuading the court to withhold its sanction.'[147] The only opportunity to voice public opposition to an offer is at the general meeting, which is itself only necessary in certain circumstances.[148] It is also possible for an organised minority of shareholders opposed to the scheme, who between them hold more than 25 percent in value of the shares represented at the shareholders' meeting, to prevent the scheme from being approved, whereas the comparative percentage required to block the passage of an offer would be more than 50 percent.[149]

Whilst the actual process of completing a takeover by an offer or a scheme is very different, the target shareholders and the bidder will generally have the same interests and want to achieve the same goals. Crucially however, the target directors interests and goals will depend upon whether the takeover is friendly or hostile, which will also impact upon how the takeover is proposed. This concludes the discussion of the process of the takeover offer and scheme of arrangement; the next sections will now turn to discuss the regulation of these processes.

### 3.3 UK Regulatory Regime: Company Law

Section 3 will be divided into four main parts. Section 3.3.1 will outline Part 28 of Companies Act 2006 ("CA"), which provides the collection of rules that are specifically focused on the takeover process, and most importantly govern the Panel and the Code. Section 3.3.7 will then turn to examine Part 27 of CA which governs the process of schemes

[146] Jennifer Payne, 'The Use of Schemes of Arrangement to Effect Takeovers: A Comparative Analysis' (Oxford University, Legal Research Paper Series 2014) 11
[147] Nigel Boardman**, '**Public Takeover Offers Versus Schemes of Arrangement' *Who's Who Legal* (March 2012) <http://whoswholegal.com/news/features/article/29552/public-takeover-offers-versus-schemes-arrangement> accessed 22 April 2015
[148] ibid
[149] Justin McKenna, David Mangan, 'Mergers and Acquisitions,' *European Lawyers Reference Series* (2012) <http://www.mhc.ie/latest/insights/merger-acquisitions-the-european-lawyer-reference-series-1st-ed-2012> accessed 23 March 2016



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of arrangements. A number of other general rules in company law which are not designed specifically for takeovers, but which may nevertheless be a relevant, and which, crucially for the purposes of this thesis, generate causes of action which might be relied on by aggrieved participants in takeovers will then be discussed in parts 3 and 4. Specifically, part 3 will explain the duties of directors, which are vital in regulating the conduct and behaviour of directors during the takeover process, and more generally in part 4 the specific causes of action available to those who wish to pursue complaints.

### 3.3.1 Part 28 of the Companies Act 2006

The Panel is regulated by the CA, and is an independent body, its main functions are to issue and administer the Code, and to supervise and regulate takeovers and other matters to which the Code applies.[150] The Panel and the Code have been in existence since 1968, when they were set up by the governor of the Bank of England and the chairman of the London Stock Exchange. The Panel's central objective is to ensure fair treatment for all shareholders during takeover bids.[151] Prior to the CA, the Panel was not regulated. Instead the Panel and Code operated as soft law, and any rulings made by the Panel were enforced by other regulatory bodies. The Panel's activities are now regulated by the CA, which also confers the Panel with its own powers. This change was in order to comply with the European Directive on Takeover Bids.[152] Because the Panel and the Code were well established prior to the enactment of the CA the Panel remains relatively free to conduct its functions as it had before the Act. The Panel and the Code are generally agreed to have been a great success, and as such have become a well-respected part of the UK financial services architecture.[153]

### 3.3.2 The Panel

Part 28 of the CA grants a number of significant powers to the Panel. Firstly, s.942 states that the Panel may do anything that it considers necessary or expedient for the purposes of, or in connection with its functions. S.943, additionally states that the Panel can make rules in connection with 'the regulation of takeover bids, merger transactions and transactions that

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[150] The Takeover Panel <http://www.thetakeoverpanel.org.uk/> accessed 16 July 2014
[151] ibid
[152] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids
[153] Alan Dignam and John Lowry, *Company Law* (9th ed, Oxford University Press 2016) 77



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have or may have, directly or indirectly an effect on the ownership or control of companies.' These sections confer enormous power to the Panel to create rules and regulate the process of takeovers via the Code. The Panel also has the power to give rulings on 'the interpretation, application, or effect of the rules.'[154] These rulings will have a binding affect[155] but can be subject to a review if appealed.[156] The Panel:

*'may give any direction that appears to be necessary in order to restrain a person from acting (or continuing to act) in breach of rules; to restrain a person from doing (or continuing to do) a particular thing, pending determination of whether that or any other conduct of theirs is or would be a breach of rules; or otherwise to secure compliance with rules.'*[157]

Failure to comply with any requirement or ruling will be a breach of the Code. It is the practice of the Panel, in discharging its functions under the Code, to focus on the specific consequences of breaches of the Code with the aim of providing appropriate remedial or compensatory action in a timely manner.[158] The Panel's remit covers public companies resident in the UK whether they are listed or not, and private companies whose shareholdings are widely dispersed.[159] The Panel has up to 35 members, representing a wide range of expertise in takeovers, securities markets, industry and commerce.[160] Membership is comprised of independent members appointed by the Panel itself with the rest appointed directly by organisations representing London's financial institutions.[161] The Panel is made up of the Executive and a number of committees, the most central being the Code committee and the Hearing committee.

The Panel's Executive comprises of full-time employees and employees on secondment from London firms. It deals with the day to day aspects of overseeing every takeover i.e. checking that all documents and announcements issued and actions taken comply with the Code.[162] The

[154] S.945 CA 2006
[155] ibid
[156] ibid
[157] S.946 CA 2006
[158] The Code, Section 10
[159] The Code, Section 3 para (a)(i)-(iii)
[160] The Takeover Panel, Panel Membership, <http://www.thetakeoverpanel.org.uk/structure/panel-membership> accessed 16 July 2014
[161] Dignam, Lowry (n153) 77, also see ibid
[162] The Code, Section 5



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Executive may be approached for general guidance on the interpretation or effect of the Code and how it is usually applied in practice.[163] This can be done on a "no names" basis, where the person seeking the guidance does not disclose to the Executive the names of the companies concerned.[164] The informal guidance given at this time by the Executive is not binding.[165] The parties seeking guidance, or their advisers, therefore cannot rely on such guidance as a basis for taking any action without first obtaining a formal ruling of the Executive on a named basis.[166] In addition to these duties the Executive also publishes practice statements from time to time, which provide informal guidance as to how the executive usually interprets and applies particular provisions of the Code in certain circumstances.[167] Practice statements do not form part of the Code and, accordingly, are not binding.[168] The Panel therefore makes it clear that the statements are not a substitute for consulting the Executive to establish how the Code applies in any one particular case.[169]

The Executive is overseen by the Hearings Committee, whose principal function is to review the rulings of the Executive. A person subject to a ruling of the Executive may therefore request the Hearings Committee to re-examine the decision. The Hearings Committee also hears disciplinary proceedings instituted by the Executive, when the Executive considers that there has been a breach of the Code or of a ruling of the Executive or the Panel.[170] There is a further right to appeal against a decision of the Hearings Committee to an independent tribunal, the independent body being the Takeover Appeal Board (the "Board").[171] The Chairman and Deputy Chairman of the board are appointed by the Master of the Rolls and will usually have held high judicial office.[172] The other members of the Board are appointed by the Chairman or Deputy Chairman, and will usually have relevant knowledge and

[163] The Code, Section 5
[164] The Code, Section 6
[165] ibid
[166] ibid
[167] ibid
[168] ibid
[169] The Code, Section 6 para 6
[170] The Takeover Panel, The Hearings Committee <http://www.thetakeoverpanel.org.uk/structure/committees/hearings-committee> accessed 11 February 2015
[171] S.951(3)
[172] The Takeover Appeal Board <http://www.thetakeoverappealboard.org.uk/> accessed 11 February 2015



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experience of takeovers and the Code.[173] No person who is or has been a member of the Code committee of the Panel may simultaneously or subsequently be a member of the Board.[174]

The functions of the Board are to 'hear and determine appeals against rulings of the Hearings Committee, to make such directions (if any) to the Panel and to make such procedural rulings in connection with the performance of its other functions.'[175] The Board may confirm, vary, set aside, annul or replace the contested ruling of the Hearings Committee. On reaching its decision, the Board 'remits the matter to the Hearings Committee with such directions (if any) as the Board considers appropriate for giving effect to its decision.'[176] The Hearings Committee will then give effect to the Board's decision.[177] These separate but distinct functions of the Panel's committees and appeal boards ensures that there are proper procedures for review of and appeal against decisions taken by the Panel in connection with its regulatory functions.[178]

The other central committee, the Code Committee, carries out the rule-making functions of the Panel and is solely responsible for keeping the Code under review and for proposing, consulting on, making and issuing amendments to the Code.[179] The Code Committee represents a variety of shareholder, corporate, practitioner and other interests within the Panel's regulated community and up to 12 members of the Panel are designated by the Panel as members of the Code Committee.[180] Matters leading to possible amendments of the Code may arise from a number of sources; including specific cases which the Panel has considered, market developments or particular concerns of those operating within the markets.[181] The Code Committee usually consults publicly on proposed amendments to the Code via a public

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[173] Takeover Appeal Board (n172)
[174] ibid
[175] The Takeover Appeal Board, Rules <http://www.thetakeoverappealboard.org.uk/rules.html> accessed 11 February 2015
[176] ibid
[177] The Code, Section 8 para 8(c)
[178] Explanatory Notes to the Companies Act 2006, para 1201
[179] The Takeover Panel, Code Committee <http://www.thetakeoverpanel.org.uk/structure/committees/code-committee> accessed 11 February 2015
[180] ibid
[181] ibid



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consultation paper. Following the end of the consultation period, the Code Committee publishes its conclusions and the final Code amendments in a response statement.[182]

### 3.3.3 The Code

The Code was developed by the Panel in order to reflect the collective opinion of those professionally involved in the field of takeovers as to appropriate business standards, fairness to offeree company shareholders and an orderly framework for takeovers.[183] The Code is therefore designed principally to ensure that shareholders in a target company are treated fairly and are not denied an opportunity to decide on the merits of a takeover, and additionally that shareholders in the target company of the same class are afforded equivalent treatment by a bidder.[184] The Code is not 'concerned with the financial or commercial advantages, or disadvantages, of a takeover.'[185] As such it will not matter that a takeover is not in the best interests of the company. In addition, the Code will not either facilitate or impede takeovers, and will not become involved with issues, such as competition policy, which are the responsibility of the government and other relevant bodies.[186]

The Code is based upon six "general principles," which are essentially statements of standards of commercial behaviour.[187] They apply to takeovers and other matters to which the Code applies, and are expressed in broad general terms. This is in order to avoid defining the 'precise extent of, or the limitations on, the application of the principles, so that they are applied in accordance with their spirit to achieve their underlying purpose.'[188] In addition to the general principles, the Code contains a series of rules. The Panel notes that although most of the rules are expressed in less general terms than the general principles, they are not framed in technical language, and like the general principles, are to be interpreted to achieve their underlying purpose.[189] Therefore, their spirit as well as their letter must be observed.[190]

[182] The Takeover Panel, Code Committee (n179)
[183] The Code, Section 2 para 2(a)
[184] ibid
[185] ibid
[186] The Code, Section 2 para (a)
[187] The Takeover Panel, The Takeover Code <http://www.thetakeoverpanel.org.uk/the-code/download-code> accessed 16 July 2014 (These General Principles are the same as the general principles set out in Article 3 of the European Directive on Takeovers)
[188] The Code, Section 2 para (b)
[189] ibid



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Both takeover offers and schemes of arrangements are regulated by the Code. The provisions of the Code therefore apply to an offer effected by means of a scheme of arrangement in the same way as they apply to a takeover effected by means of an offer, except as set out in the scheme focused, Appendix 7 of the Code.[191] The Code does however have a greater focus on the regulation of takeover offers than schemes of arrangement. This may change in the future as schemes are growing in popularity as a means of affecting a takeover. The above gives a general overview of the Code. This section will now go on to outline the specific rules of the Code and its regulation of the takeover process.

Before approaching a target or buying a substantial percentage of shares in a company, a potential bidder must consider the significance of Rule 9 of the Code, the mandatory bid rule. This rule states that a shareholder, or a concert party,[192] who acquires more than 30 percent of a company must make an offer to buy the remaining shares of that company. A bidder must therefore be prepared to make an offer for one hundred percent of the shares in the target company if they intend to purchase over 30 percent of shares/voting rights. This rule requires the bidder to treat all shareholders equally by offering them the same price for their shares, and on terms as good as their most recent purchases of shares within the same company (within a 12 month period). Any purchase which results in a mandatory offer being required must be immediately followed by an announcement that an offer for the company is to be made.

If a purchase has resulted in a mandatory offer being required, but the purchaser does not want to make an offer for the whole company, they may under Rule 9.7, apply to the Panel to request a disposal of their interests in shares. The Panel must be consulted as to the interests required to be disposed of and the application, pending completion of the disposal, of restrictions on the exercise of the voting rights attaching to the shares in which that person (or

[190] The Code, Section 2 para (b)
[191] The Code, Appendix 7 para 7.1
[192] 'Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), co-operate to obtain or consolidate control of a company or to frustrate the successful outcome of an offer for a company.' Control for the purposes of the Code means an interest, or interests, in shares carrying in aggregate 30 percent or more of the voting rights of a company. Certain persons will be presumed to be persons acting in concert with other persons in the same category, unless the contrary is established. See Code Rule 9



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persons acting in concert with that person) are interested. If a bidder has not triggered the mandatory bid rule they can approach the target company informally.

The Code requires parties to a bid to maintain absolute secrecy in the early phases of a bid prior to a formal announcement, in order to prevent the creation of false markets. If the Panel determines that there has been a leak in respect of a potential offer (evidenced by an untoward movement in the target stock price, or rumour and speculation) the parties must release a public announcement. If there hasn't been a leak, an announcement is generally required when a firm intention to make an offer is notified to the board of the target company; or, as noted above, immediately upon an acquisition of any interest in shares which gives rise to an obligation to make an offer under Rule 9 (mandatory offer).

When approaching a target company, the Code makes it clear that a bidder must not be hindered in the conduct of their affairs for longer than is reasonable. This is because takeovers can be disruptive and destabilising not only to the target company but to the market as a whole. The Code therefore establishes a fairly rigid timetable for the entirety of the bid.[193] In the initial stages of the approach, the potential bidder has 28 days in which to consider making an offer. On the 28th day, if the bidder hasn't already made a decision about the offer they must either "put up or shut up." In more specific terms the bidder must either announce a (fully financed) bid; obtain the agreement of the target and the Panel to an extension of that deadline; or walk away, in which case the bidder is precluded from making another bid for six months (except in limited circumstances).[194] The target company should therefore not be subject to an offer, or speculation regarding an offer, for an excessive period of time. The formal offer, when made, must provide shareholders with a significant amount of information about the bid, the intention being that '[s]hareholders must be given sufficient information and advice to enable them to reach a properly informed decision as to the merits or demerits of an offer.'[195]

[193] Code Rules 30–35
[194] Code Rule 30.1
[195] Code Rule 23



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The Code additionally imposes significant restrictions on the ability of the bidder to place conditions on the offer, because shareholders should have a clear offer to either accept or reject.[196] One condition that will always be present in a bid however, because it is required by the Code, relates to when an offer will become unconditional.[197] The Code states that 'an offer for voting securities will be conditional on acceptances being secured by the bidder sufficient to give it, together with securities already held, more than 50 percent of the voting rights in the target.'[198] A bidder can however set a higher level than 50 percent.[199] An important stage in any bid is therefore when it becomes "unconditional as to acceptances," which means that it has satisfied all of its conditions (including passing the 50 percent hurdle, or such higher hurdle as the bidder has imposed on the bid) and the bid has effectively succeeded.[200] Once the formal offer documents have been posted to the shareholders, the bid is open to acceptance by the shareholders to whom it is addressed. The offer must be kept open for acceptance for at least 21 days.[201] After an offer has become unconditional as to acceptances, the offer must then remain open for at least a further 14 days.[202]An unsuccessful bidder may not normally make another offer for the same target within 12 months.[203] This is because the Panel's goal is to resolve bidding situations quickly and with minimum uncertainty.[204] In the context of an active bid, the Panel requires participants to give it regular updates on compliance. Faced with a protest by one of the parties, it will issue rulings as appropriate. The informality of the Panel enables it to respond almost immediately.

Defensive action may not be taken by a target company during a takeover bid unless they have the consent of the shareholders. Rule 21 states that:

*'during the course of an offer, or even before the date of the offer if the board of the offeree company has reason to believe that a bona fide offer might be imminent, the board must not, without the approval of the shareholders in general meeting…take any action which*

[196] Payne (n146) 7; Code Rule 13
[197] Payne (n146) 7
[198] Code Rule 10
[199] ibid
[200] Payne (n146) 8
[201] Code Rule 31.1
[202] Code Rule 31.4
[203] Code Rule 35.1
[204] Armour, Skeel (n34) 1745



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*may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits.'*

Simply put, the board of the target company cannot take any action which may frustrate an offer, which either has been formally made or they have reason to believe will be made, without the consent of the shareholders. The rule contains a list of examples of actions which will frustrate a bid:

*'(i) issue any shares or transfer or sell, or agree to transfer or sell, any shares out of treasury;*

*(ii) issue or grant options in respect of any unissued shares;*

*(iii) create or issue, or permit the creation or issue of, any securities carrying rights of conversion into or subscription for shares;*

*(iv) sell, dispose of or acquire, or agree to sell, dispose of or acquire, assets of a material amount; or*

*(v) enter into contracts otherwise than in the ordinary course of business.'*[205]

Frustrating action is not however limited to these particular scenarios. Any action which interferes with the bid will be considered frustrating. 'The characterisation of an act of the target board as frustrating to target shareholders focuses on the effect of the act on target shareholders' ability to exercise their proprietary rights.'[206] Frustrating action can also include any litigation which would prevent a bid from proceeding. The Panel will then normally prohibit the target board from commencing legal action which might have the effect of frustrating a bid, regardless of the perceived merits of the claim in question, unless shareholder consent has been obtained.[207] As noted above the Code is designed to ensure that

[205] Code Rule 21

[206] Ogowewo (n2) 598; see also the Panel's statement in John Crowther Group Plc, 1988/9, 1 that '[r]ule 21 of the Code is designed to stop the board of an offeree taking certain actions where these could be unfair to an offeror'

[207] The Panel on Takeovers and Mergers, Panel Statement Consolidated Gold Fields Plc 1989/7 2 <http://www.thetakeoverpanel.org.uk/new/statements/DATA/1989/1989-07.pdf > (Panel ruling forbidding Consolidated Gold Fields from taking legal action against a potential acquirer unless 'the directors obtain shareholders' approval')



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shareholders are treated fairly and are not denied an opportunity to decide on the merits of a takeover, and that shareholders of the same class are afforded equivalent treatment by an offeror.

The non-frustration rule was therefore established to serve this purpose, and to set management aside when hostile bids are imminent so that shareholders have the final say on the merit of the bids. If a hostile bidder launches a takeover effort and believes that the target's managers are interfering with the bid, the bidder can lodge a protest with the Panel. The no frustrating action principle of the Code, however only becomes relevant when a bid is on the horizon. In the UK provisions dealing with changes of control may be acceptable when they form part of a wider transaction.[208] The concept of "bona fides offer" is one that focuses on the credibility of a possible offer and it's financing, as opposed to the ethics of the business intentions of the bidder.[209]

### 3.3.4 Enforcement of the Code

Where the Panel considers that there has been a breach of the Code, the Panel's executive may commence disciplinary proceedings before the Hearings committee. If the Hearings committee finds a breach of the Code or of a ruling of the Panel, it may: (i) issue a private statement of censure; or (ii) issue a public statement of censure; or (iii) suspend or withdraw any exemption, approval or other special status which the Panel has granted to a person, or impose conditions on the continuing enjoyment of such exemption, approval or special status, in respect of all or part of the activities to which such exemption, approval or special status relates; or (iv) report the offender's conduct to a UK or overseas regulatory authority or professional body (most notably the FCA) so that that authority or body can consider whether to take disciplinary or enforcement action (for example, the FCA has power to take certain actions against an authorised person or an approved person who fails to observe proper standards of market conduct, including the power to fine); or (v) publish a Panel statement

[208] Charles Proctor, 'Criterion Properties in the House of Lords - Poison Pills , Changes of Control and Directors Duties' (2004) Company Law Newsletter 1

[209] Ogowewo (n2) 598; See The Code, Section 2 para (a) (The Code is not concerned with the financial or commercial disadvantages of a takeover)



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indicating that the offender is someone who, in the Hearings committee's opinion, is not likely to comply with the Code.[210]

The Panel statement will normally indicate that this sanction will remain effective for only a specified period. The rules of the FCA and certain professional bodies oblige their members, in certain circumstances, not to act for the person in question in a transaction subject to the Code, including dealing in relevant securities requiring disclosure (so called ''cold-shouldering'').[211] For example, the FCA's rules require a person authorised under the Financial Services and Markets Act 2000 not to act, or continue to act, for any person in connection with a transaction to which the Code applies if the firm has reasonable grounds for believing that the person in question, or their principal, is not complying or is not likely to comply with the Code.[212] The "harshest sanction," cold shouldering, has been rarely employed by the Panel. In 2010 a London tycoon, Brian Myerson, and two of his associates received three year cold shouldering penalties for breaching the Code. The Panel noted that the three had been "disingenuous and dishonest."[213] The cold shoulder order effectively barred the three from any takeover-related activity, including buying or selling shares during a live takeover period.[214] The penalty meant that no firm regulated by the FCA could act for the cold shouldered individual in a takeover situation. [215]

### 3.3.5 Change in the Legal Status of the Panel

In 2007 the European Commission passed the Directive on Takeover Bids,[216] with the aim of harmonising takeover provisions within the EU.[217] While the UK government emphasised that the final form of legislation implementing the Directive retains independence of the Panel, the Directive required the establishment of a statutory body which would oversee

[210] Code Section 11 para (b)
[211] Code Section 11 para (b)(iv)
[212] Code Section 11 para (b)(v)
[213] Simon Bowers, 'Takeover Panel gives Brian Myerson 'cold shoulder' over secret concert-party' *The Guardian* (London 14 July 2010) <http://www.theguardian.com/business/2010/jul/14/takeover-panel-coldshoulders-brian-myerson> accessed 3 June 2015
[214] ibid
[215] ibid
[216] Takeover Directive (n152)
[217] Dignam, Lowry (n153) 79



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statutory takeover provisions.[218] The CA Part 28 in effect converted the Panel (s.942) into the required statutory body to oversee takeovers in the UK. Under the directive reforms the Panel subsequently has its own range of sanctions contained in The CA 2006 ss.952-956 (as discussed above). This meant that the Panel was given formal powers to issue statements of censure, issue directions, refer conduct to other regulatory bodies, order compensation to be paid for breach of the Code and refer a matter for enforcement by the court. The Directive has, however been implemented in a manner that enables the Panel to preserve its self-regulatory advantages by retaining the power to make, interpret and apply the rules, and enforcing them on its subjects. Takeovers subject to the Code are therefore still largely governed by soft law rules. The Directive may not form part of the picture of regulation of takeovers in the UK after Brexit.

The Panel has stated that the impact of Brexit on the framework of takeover regulation will depend upon the form of exit that the UK negotiates.[219] If the UK becomes a member of the European Economic Area ("EEA"), the Takeovers Directive "would continue to apply,"[220] although this seems unlikely at present. If the UK does not remain in the EEA, 'the Panel will seek to discuss with Government the extent to which Chapter 1 of Part 28 of the CA, which implemented the Directive in the UK, should be amended.'[221] The Panel has concluded however that Brexit, whether the UK stays in the EEA or not, will have "relatively few direct consequences" for the Code.[222]

### 3.3.6 Squeeze-out and Sell-out Rights

If a bid has been successful, but the bidder has not acquired one hundred percent of the shares, the CA includes provisions for a squeeze-out right,[223] which enables a majority shareholder to require the remaining minority shareholders to sell their securities at a fair price in connection with takeover offers in the following situations: (i) If the bidder holds

[218] Dignam, Lowry (n153) 79
[219] The Takeover Panel, Reports and Accounts for the Year Ended 31 March 2016 (2016)
[220] ibid 9
[221] ibid
[222] ibid (Other than in certain limited respects, for example in the provisions for regulating "shared jurisdiction" cases with takeover regulators in other EEA member states)
[223] s.979 CA 2006



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securities representing at least 90 percent of the capital carrying voting rights and 90 percent of the voting rights in the target company; or (ii) if through acceptance of the takeover offer, the bidder has acquired or firmly contracted to acquire securities representing at least 90 percent of the capital carrying voting rights and 90 percent of the voting rights comprised in the takeover offer.

These provisions also give a sell-out right[224] which enables minority shareholders to require the majority shareholder (the bidder) to buy their securities following a takeover offer for fair consideration. This is, however, only if the bidder meets the requirements for the takeover-related squeeze-out. The right of squeeze-out and the right of sell-out however can only be exercised within three months after the end of the acceptance period.

### 3.3.7 Part 26 of the Companies Act 2006

Schemes of arrangement, like an offer, are an amalgamation of both statutory law under the CA and soft law under the Code, but unlike offers, they are more heavily regulated by statute, specifically Part 26 of the CA. A scheme of arrangement is defined by s.895(1) CA as 'a compromise or arrangement [that] is proposed between a company and (a) its creditors, or any class of them, or (b) its members, or any class of them.'[225] Nothing in the CA however prescribes the subject matter of a scheme. In theory a scheme could be a compromise or arrangement between a company and its creditors or members about anything which they can properly agree amongst themselves.[226] The phrase "a compromise or arrangement" within s.895 CA has been construed widely by the courts. All that is required is some difficulty or dispute which the scheme seeks to resolve.[227] The courts have not sought to provide a definition of the term "arrangement" for these purposes, limiting it only to the extent that the arrangement must have the features of "give and take."[228] It is therefore ideal for a situation in which two companies agree to a takeover.

[224] S.983 CA 2006
[225] s 895(1) CA 2006
[226] (n146) 1
[227] Sneath v Valley Gold Ltd [1893] 1 Ch 477; Re NFU Development Trust Ltd [1972] 1 WLR 1548
[228] Re Savoy Hotel Ltd [1981] 3 All ER 646.



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As noted above, a scheme will commence when the bidder and target board agree to a scheme. Once a proposal is put forward to the shareholders, an application must be made to the court in order to hold a meeting of the shareholders and creditors to vote on the scheme.[229] Where a meeting is summoned a notice must be sent to the shareholders and creditors together with a statement.[230] The statement must explain the effect of the scheme, and in particular, state any material interests of the directors of the company (whether as directors, or as members, or as creditors of the company, or otherwise), and the effect on those interests of the scheme, in so far as it is different from the effect on the likely interests of other persons. If a majority representing 75 percent of the creditors or members present and voting, either in person or by proxy, at the meeting agrees to a scheme the court may then on an application, sanction the scheme.[231] A scheme sanctioned by the court is then binding on the company and the bidder acquires 100 percent of the shares.[232]

### 3.3.8 Directors' Duties

Directors' duties originally evolved from common law and have now been codified in the CA under s.171 to s.177. They are owed by the director, not to the shareholders, but to the company.[233] If a director breaches a duty then the wrong is done to the company itself.[234] The company, however, is not seen as wholly distinct from the shareholders who have interests that identify with those of the company.[235] Except as otherwise provided, more than one general duty may apply in any given case;[236] as such duties can be cumulative, and a director can be found to be liable under one or more provisions. Enforcement of directors' duties will be left to the company itself however there are provisions[237] which allow shareholders to bring claims against directors for breaches of duties on behalf of the company.

[229] s.896 CA 2006
[230] s.897 CA 2006
[231] s.899 CA 2006
[232] s.899(3) CA 2006
[233] S.170 CA 2006
[234] Foss v Harbottle [1843] 67 ER 189
[235] Greenhalgh v Arderne Cinemas Ltd and Another [1946] 1 All ER 512
[236] S.179 CA 2006
[237] S.260 CA 2006



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There are a number of duties which a director must consider before and during a takeover bid. For example, a director has a duty to avoid conflicts of interest under s.175. This section requires directors to avoid situations in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This 'applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).'[238] Directors must not accept benefits from third parties under s.176 and must declare any interests that they have (either directly or indirectly) in a proposed transaction or arrangement, such as a takeover or scheme.

Directors have also been found to owe fiduciary duties which require disclosure to shareholders during a takeover bid.[239] The most relevant of these duties however are s.171 to act within their powers, s.172 to promote the success of the company, and s.174, which requires a director to exercise reasonable care, skill and diligence. Each of these duties will now be discussed in turn.

#### 3.3.8.1 Duty to Act Within Powers

Under s.171 directors must act in accordance with the company's constitution, and only exercise their powers for the purpose for which those powers are conferred. An example of a breach of this duty in a takeover scenario would be the use of defences to prevent a bid from being successful, such as employing pre or post bid defences[240] when the director has no power to do so, or the shareholders have not agreed to take that action. This would however, also be regulated by Rule 21 of the Code.

In order to assess whether this duty has been breached, the courts will first look to the company's articles and constitution to determine whether the power has been conferred to the director and then whether the particular purpose for which they exercised that power is

[238] S.175(2) CA 2006
[239] s.175 s.177 s.182 CA 2006; See also S.190 CA 2006
[240] Taking any frustrating action post-bid is also a breach of the Code under Rule 21



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proper.[241] If a director has exercised a power which has not been granted to them they will be in breach of this duty. If the company's constitution has granted the powers to the directors to undertake certain actions, they may still be in breach of this duty if they have not exercised that power appropriately. For example, if a power is exercised primarily for some other collateral purpose, which will be objectively assessed by the courts, then the director is guilty of an abuse of power and their action can be set aside. Directors must therefore exercise discretion in what they consider is in the interest of the company, and not for any other collateral purpose.[242] So even if the director acted honestly they may be in breach of their duty if they have exercised their powers for a purpose outside those for which their powers were conferred upon them.[243] The courts have however acknowledged that there might be a range of purposes associated with a particular action of directors;[244] in this case the test is applied to the dominant or primary purpose of the directors' actions.[245]

Howard Smith Ltd v Ampol Petroleum Ltd[246] illustrates how the courts will determine a director's primary purpose or motivation. In this case a majority shareholder (Ampol) in a company (Miller) made an offer to acquire the remaining shares. The directors of Miller however preferred a takeover offer from Howard Smith, but this could not succeed as long as Ampol retained its majority shareholding. The directors therefore issued new shares to Howard Smith in order to reduce Ampol to a minority position. Ampol claimed that this issue of new shares involved the directors acting for an improper purpose. The court however rejected the idea that the only purpose of an issue of new shares was to raise new capital for the company when it needed it. There could be other, proper, purposes involved in a share issue. In this case, however, no such alternative purpose was evident. The only purpose was to block the bid by Ampol. Even though the directors in that case were not acting self-interestedly, they were held to be in breach of the proper purpose rule. This case developed a two-fold process for determining a breach of the duty to act within powers.[247] Firstly, the

[241] Re Smith and Fawcett Ltd [1942] Ch 304 [306]
[242] ibid
[243] Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 [834]; Punt v Symons and Co Ltd [1903] 2 Ch 506
[244] S.171 (b) CA 2006
[245] Hirsche v Sims [1894] AC 654
[246] Howard Smith (n243)
[247]Dignam, Lowry (153) 341



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courts will consider the power in question, and the limits in which they may be exercised; and secondly, the substantial purpose for which the power was exercised.

Whilst judges will not challenge the director's judgment and will take into account the subjective intention of the director, they will ultimately take an objective approach in deciding whether the director has acted within their powers, and their primary motivations for doing so. It is therefore not sufficient for directors to act in what they believe is in the best interests of the company unless they can also establish that their actions are within the scope of the powers conferred to them. As long as a director can satisfy to the court that the primary purpose of the action was indeed proper, then they will not be in breach of this duty even if the incidental result is to secure the director's control of the company. In Criterion Properties plc v Stratford UK Properties[248] a poison pill arrangement was entered into by Criterion and another company. The agreement ultimately deterred a takeover from occurring. The court held that the agreement could not only be triggered by a hostile takeover, but even one that was wholly beneficial, and as such was an improper use of the directors' powers to bind the company.[249] The court looked at the directors' authority in particular and found that the directors did not have actual, apparent or ostensible authority to sign the poison pill agreement.[250]

3.3.8.2 Duty to Promote the Success of the Company

A director of a company must act in a way which he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole; and in doing so have regard to other stakeholders such as employees, creditors and the community.[251] Directors are thus precluded from exercising their powers to further their own interests or the interests of some third party.[252] During a takeover a director must therefore act in the best interests of the company, and as such advise shareholders honestly about the merits of the offer or proposed scheme of arrangement. For example, this duty means that a director cannot advise against a takeover just because they are worried they will lose their

[248] [2004] UKHL 28
[249] [2004] UKHL 28
[250] See (n153) 346
[251] S.172(1) CA 06
[252] Dignam, Lowry (n153) 348



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position, or be in favour of the takeover if it is only in their interests to do so, even though it would not be beneficial to the company.

The directors' duty to promote the success of the company is a subjectively assessed obligation. In assessing breaches of this duty the courts will therefore consider whether the director exercised their discretion bona fide in what they consider, not what the courts may consider, to be in the interests of the company.[253] Self-dealing on the part of the directors and giving preference to one shareholder group over and above the shareholders as a whole, are types of motivation which could lead a court to conclude that the directors had not acted in good faith for the benefit of the company.[254]

Under this duty the director is also required to have regard to the likely long-term consequence of their decisions. This is specifically relevant in a takeover contest, for instance, a director must consider whether the prospect of the bidder taking control of the company is harmful to the company's long-term business plans. The basis of the duty is therefore not just confined to the existing body of shareholders but also future shareholders.[255] Where the directors must only decide between rival bidders, however, the interests of the company must be the interests of the current shareholders.[256] This is because the future of the company will lie with the successful bidder.[257] Where directors are required to give advice to current shareholders in respect of an offer, they have a duty to advise in good faith and not fraudulently, and not to mislead whether deliberately or carelessly.[258] Provided directors act in good faith and in the interests of the company, and are not wilfully blind to the company's interests they will not be liable for breach of this duty if they make a mistake and/or act unreasonably.[259]

[253] Re Smith and Fawcett Ltd (n241)
[254] Sun Trust Co v Begin (1937) (Supreme Court of Canada)
[255] Ross Grantham, 'The Doctrinal Basis of the Rights of Company Shareholders' (1998) 57 The Cambridge Law Journal (1998) 554
[256] Heron International v Lord Grade [1983] BCLC 244
[257] ibid
[258] Dawson International plc v Coats Paton plc [1989] BCLC
[259] (n153) 350; see also Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd [2002] All ER (D) 226 (Dec) (under these circumstances the director may be in breach of the duty of care instead.)



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3.3.8.3 Duty to Exercise Reasonable Care, Skill and Diligence

The level by which the director will be judged will be what a reasonably diligent person may be expected to have done, having regard to the director's particular role and experience.[260] In order to determine whether a director has breached this duty the courts will therefore look at the director's actions in both a subjective and objective manner. Subjective considerations will include whether the director has any special skills. A director must also acquire and maintain sufficient knowledge of the company's business in order to enable them to discharge their responsibilities.[261]

### 3.3.9 Causes of Action under Company Law

3.3.9.1 Unfair Prejudice

A shareholder may apply to the court by petition for an order using s.994 (unfair prejudice) on the ground that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.

In order to satisfy a claim under s.994 the conduct must be unfair and prejudicial in the sense of causing prejudice or harm to the relevant interest of the members or some part of the members of the company (shareholders). The test as to what amounts to unfair prejudice is objective. It is accordingly unnecessary for the claimant to show that the persons controlling the company have acted deliberately in bad faith, or with a conscious intent to treat them unfairly. Fairness is judged in the context of a commercial relationship, the contractual terms of which are set out in the articles of association of the company and in any shareholders' agreement. The starting point is, therefore, to ask whether the conduct which the shareholder

[260] S.174(2) CA 2006

[261] Re Barings plc (No 5) [1999] 1 BCLC 433; see John Lowry, 'The Irreducible Core of the Duty of Care, Skill and Diligence of Company Directors: *Australian Securities and Investments Commission* v *Healey*' (2012) 75 Modern Law Review 249 (Lowry considers the power of directors to delegate areas of responsibility requiring specialist knowledge and the degree of permissible reliance on professional advisers, which is particularly relevant to a takeover scenario)



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has complained about is in accordance with the articles and the powers that the shareholders have entrusted to the board.

The rights of the shareholder must then have been prejudiced. A member's interest is not limited to their strict legal rights under the articles of association, but can extend to legitimate expectations arising from the nature of the company, as well as agreement and understandings between the parties. Common examples of what may constitute unfairly prejudicial conduct are: exclusion from management in circumstances where there is a legitimate expectation of participation; diversion of business to another company in which the majority shareholder holds an interest; the awarding of excessive financial benefits by the majority shareholder to themselves, and abuses of power and breaches of the articles of association.

S.996 lists particular types of orders which may be made by the court if it decides that there has been unfair prejudice. The powers listed provide that the court can: regulate the conduct of the company's affairs in the future; require the company to refrain from doing or continuing an act complained about, or to do an act which the petitioner has complained that it has omitted to do; authorise civil proceedings to be brought in the name and on behalf of the company by such persons and on such terms as the court may direct; require the company not to make any, or any specified, alterations in its articles without relief of the court; provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of the purchase by the company itself, the reduction of the company's capital accordingly.

#### 3.3.9.2 Other Causes of Action under Companies Act 2006

There are other causes of action in which a claim can be brought, in regards to the examples of complaints highlighted above. These causes of action are under s.33, s.549, s.793, s.803 and s.911B of the CA 2006. This section will give a brief description of each section and the actions that can be brought.



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A claim can be brought via s.33 which concerns a breach of the companies' articles. s.549 covers the directors power to allot shares, and states that the directors of a company must not exercise any power of the company to allot shares in the company, or to grant rights to subscribe for, or to convert any security into, shares in the company, except in accordance with s.550 (private company with single class of shares) or s.551 (authorisation by company).

S.793 allows a company to impose restrictions on shares. A public company may give notice under this section to any person whom the company knows or has reasonable cause to believe to be interested in the company's shares, or to have been so interested at any time during the three years immediately preceding the date on which the notice is issued. The notice may require the person to confirm that fact or to state whether or not it is the case, and if he holds, or has during that time held, any such interest, to give such further information as may be required. For instance, the notice may require the person to whom it is addressed to give particulars of his own present or past interest in the company's shares (held by him at any time during a three year period). S.803 gives the members of a company the power to require it to exercise its powers under s.793. A company is required to do so once it has received requests (to the same effect) from members of the company holding at least 10 percent of such of the paid-up capital of the company as carries a right to vote at general meetings of the company (excluding any voting rights attached to any shares in the company held as treasury shares). A request will specify the manner in which the company is requested to act, and give reasonable grounds for requiring the company to exercise those powers in the manner specified.

S.911B concerns the reporting on material changes of assets of merging companies. The directors of each of the merging companies must report to every meeting of the members, or any class of members, of that company summoned for the purpose of agreeing to the scheme, and to the directors of every other merging company, any material changes in the property and liabilities of that company between the date when the draft terms were adopted and the date of the meeting in question. The directors of each of the other merging companies must in turn report those matters to every meeting of the members, or any class of members, of that company summoned for the purpose of agreeing to the scheme: or send a report of those matters to every member entitled to receive notice of such a meeting. The requirement in this



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section is however subject to s.915A (other circumstances in which reports and inspection not required) and s.918A (agreement to dispense with reports etc).

## 3.4 Other Relevant Regulation

As noted already, much of the takeover process depends upon ‘private ordering’, in the sense of agreements reached between the parties. This section will therefore consider the law which may regulate these agreements and the extent to which these agreements may also serve to constrain takeover participants, in that they may become a cause of action to pursue a complaint. This section will therefore discuss other important regulation pertaining to a takeover, contract law, judicial review and common law fiduciary duties.

### 3.4.1 Other Legislation

Whilst the CA is the main piece of legislation regulating takeovers in the UK, there are a number of other laws that regulate the takeover process. This other legislation includes: the Fair Trading Act 1973 (“FTA”); the Misrepresentation Act 1967 (“MA”); and the Financial Services and Markets Act 2000 (“FSMA”), all of which will now be discussed.

Under s.75 FTA the Secretary of State can request a merger reference to be made to the Monopolies and Mergers Commission where it appears that it is or may be the fact that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation. Where a merger reference is made under this section, it shall be unlawful, except with the consent of the Secretary of State for any party involved to directly or indirectly acquire an interest in the shares of the companies.

S.2(1) MA allows a person who has entered into a contract after a misrepresentation has been made to him by another party, and as a result thereof he has suffered loss, to claim damages. The person making the misrepresentation would be liable for damages in respect of the misrepresentation if they have been made fraudulently. The person shall be liable



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notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable grounds to believe, and did believe up to the time the contract was made, that the facts represented were true.

S.90 FSMA concerns the accurate and timely publishing of information on listing securities. Any person responsible for listing particulars is liable to pay compensation to a person who has acquired securities to which the particulars apply, and suffered loss in respect of them as a result of any untrue or misleading statement in the particulars; or the omission from the particulars of any matter required to be included. If listing particulars are required to include information about the absence of a particular matter, the omission from the particulars of that information is to be treated as a statement in the listing particulars that there is no such matter. Any person who fails to comply is liable to pay compensation to any person who has acquired securities of the kind in question, and suffered loss in respect of them as a result of the failure. The particulars must contain all such information as investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities; and the rights attaching to the securities.

### 3.4.2 Contract Law

Contract law only regulates the takeover process if there is an existing contract between the parties. A contract may be formed, for instance, if the parties agree to a standstill clause. A claim can be brought under contract law for a breach of contract or for a negligent misstatement made during the takeover process. A negligent misstatement is a false statement of fact made honestly but carelessly where the circumstances disclose a duty to be careful.[262] A statement of opinion, such as a directors' opinion on the merits of a takeover, may be treated as a statement of fact if it carries the implication that the person making it has reasonable grounds for trusting his opinion.[263] A negligent misstatement is however only actionable in tort if there has been breach of a duty to take care in making the statement that

[262] Nocton v Lord Ashburton [1914] AC 932
[263] Hedley Byrne v Heller & Partners Ltd [1964] AC 465 (HL)



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has caused damage to the claimant.[264] There is no general duty of care in making statements, particularly in relation to statements on financial matters.[265] Responsibility for negligent misstatements is imposed only if they were made in circumstances that made it reasonable to rely on them.[266]

### 3.4.3 Judicial Review

Judicial review claims are actions taken by parties to the bid against the Panel on a point of law, and take place once the bid has been completed.[267] The court thus only considers intervening, if at all, later and in retrospect by declaratory orders which would enable the Panel not to repeat any error, and would relieve individuals of the disciplinary consequences of any erroneous finding of breach of the rules.[268] Subsequently this type of litigation cannot be used tactically to frustrate a bid.

### 3.4.4 Common Law (non-directorial) Fiduciary Duties

These are common law duties which are not related to those duties owed by the director to the company, but are duties owed specifically in a fiduciary relationship. Fiduciary relationships are those between trustee and *cestui que trust*, such as solicitor and client, parent and child, or guardian and ward.[269] There are other circumstances in which the law imposes a duty to be careful, which is not limited to a duty to be careful to avoid personal injury or injury to property but covers a duty to avoid inflicting pecuniary loss, provided always that there is a sufficiently close relationship to give rise to a duty of care.[270] This duty could arise between the bidder and the target company, or between these parties and their advisors (such as their legal or financial advisors). In order for a duty of care to arise three elements need to

[264] Hedley Byrne v Heller (n263)
[265] ibid
[266] ibid; see also Caparo Industries plc v Dickman [1990] 2 AC 605 (HL)
[267] In the takeovers field, in the Datafin case (R v Panel on Takeovers, ex parte Datafin plc [1987] QB 815) the Court of Appeal concluded that generally the courts should limit themselves only to reviewing the Panel's decision-making processes after the bid has been concluded.
[268] ibid
[269] Hedley Byrne v Heller (n263) per Lord Hodson [10]
[270] ibid



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exist: there must be reasonable foreseeability; a close and direct relationship of 'proximity' between the parties; and it must be fair, just and reasonable to impose liability.[271]

The duty of avoiding conflicts of interest (which is also linked with a duty of confidence) was discussed in the Marks and Spencer v Freshfields case in which the court noted that in respect of a firm of lawyers acting for both bidder and target:

> '[A] *fiduciary cannot act at the same time both for and against the same client, and his firm is in no better position. A man cannot without the consent of both clients act for one client while his partner is acting for another in the opposite interest. His disqualification has nothing to do with the confidentiality of client information. It is based on the inescapable conflict of interest which is inherent in the situation*.'[272]

### 3.5 Conclusion

There are two main ways in which a takeover can be completed in the UK: via a takeover offer, or a scheme of arrangement. The method that will be used will generally depend upon whether the bid is hostile or friendly. For example, if the bid is hostile then the takeover would have to be completed via a takeover offer. The takeover offer and scheme of arrangement are regulated primarily by the Code, and by certain provisions of company law. The Panel plays a key role in the regulation of takeovers in the UK by ensuring that the Code is adhered to, giving guidance, and dealing with any breaches of the Code and regularly updating and changing the rules of the Code. The behaviour of the target director, which includes whether any defensive mechanisms are used to defeat takeovers, is regulated by the Code, but for the main part is enforced by directors' duties within the CA. Directors will therefore find it extremely difficult to defend against an unwanted takeover. The UK system of regulation is primarily aimed at empowering the target shareholders to decide on the merits of the bid, and whether a company is taken over (either by a takeover offer or scheme of arrangement).

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[271] Bristol and West Building Society v Mothew [1996] EWCA Civ 533

[272] Marks and Spencer plc v Freshfields Bruckhaus Deringer (a Firm) [2004] 1 W.L.R. 2331 Per Lawrence Collins J [13]; see also Prince Jefri Bolkiah v KPMG [1999] 2 AC 222 , per Lord Millett [234–235]



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# Chapter Four

## UK Takeover Litigation: Typology and Propensity

### 4.1 Introduction

The previous chapter described the regulatory regime for takeovers in the UK. This chapter will now turn to mapping the "litigation landscape" of UK. It is often assumed that the UK has little propensity to litigate over issues arising from takeover disputes,[273] but the actual levels of this litigation have yet to be ascertained. The aim of this chapter is to establish those levels by revealing the findings of the empirical study undertaken to identify UK takeover cases. This chapter will also identify what causes of action generate litigation in the UK, who instigates this litigation, and who is the subject of these complaints. In determining the actual levels of takeover litigation other questions can begin to be answered, such as explaining the UK's propensity to litigate, comparing those levels to other jurisdictions like the US, and answering whether the level of litigation in the UK is indeed advantageous or not.

An initial hurdle to ascertaining the level of litigation, however, is that the category of "takeover litigation" is not objectively given; cases are not reported bearing the label "takeover case." For this reason, what constitutes takeover litigation or a "takeover case" was determined by a number of different factors. Firstly, the litigation must involve a "takeover agreement," such as a scheme of arrangement, a "takeover bid" (whether the bid has been formally made or not, in line with the Code understanding that a bid is something which may be on the horizon) or any other agreement that would result in a change of control. Secondly the type of complaint which motivated the litigation had to involve a complaint about the process or effect of the takeover. These features cannot however be immediately identified. A list of complaints that may arise from the process or effect of a takeover was therefore compiled, and from this list, causes of action in which to pursue these complaints via litigation were identified.

[273] See Armour, Skeel (n34); Mukwiri (n2); Ogowewo (n2)



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The next section, section 4.2, sets out the typology of the range of complaints a party to a takeover may have, and section 4.3, discusses the potential causes of action which may arise from these complaints. The causes of action that were identified were then used as a basis for the search undertaken to establish the propensity of the main parties to a UK takeover to litigate during or after the takeover process. These main parties to a takeover were identified as the target company, target directors, target shareholders, the bidder and the bidding shareholders. The methods of this search are outlined in section 4.4 and the results are discussed in section 4.5. Section 4.6 identifies whether the complaints listed in section 4.2 are covered by the Code, and therefore can be pursued via dialogue with the Panel. Section 4.6 also outlines the number of Panel decisions that have been made in regards to some of these complaints. This is in order to compare the rate of litigation identified in section 4.5 to the decisions made by the Panel, and determine whether the level of litigation also reflects in the level of Panel decisions made.

### 4.2 Typology of Range of Complaints

In order to determine what takeover litigation might be, it is first necessary to think of all the possible complaints a party to a takeover may have during and after the takeover process.[274] This is because the complaints give a basis in which to begin to isolate the legal causes of action the parties could use in order to pursue their complaint via litigation. These complaints are linked to the different interests and goals of the different parties to a takeover[275] that would arise during the takeover, or after the takeover has been completed (or failed). Table 1 below lists the substance of these complaints, the complainant (who is making the complaint) and the target of the complaint (who they would be complaining about). It must be noted that the majority of the complaints listed are specific to takeover bids, rather than schemes of arrangements. However there are some similar complaints which can arise from both methods of takeover, for example those listed within column 2A regarding target shareholder complaints. Some of these complaints are expanded upon further below Table 4.1. The abbreviations are also explained after the table.

[274] For the purposes of this study the focus is upon the main parties to a takeover bid, i.e. the target shareholders and bidder. Additionally, only civil complaints are to be included and therefore any complaints that would lead to a criminal conviction have been excluded.

[275] The target company, target shareholders, bidding company and bidding shareholders



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**Table 4.1**

| | Complaint | |
|---|---|---|
| **Complainant** | **Target of Complaint** | **Substance of Complaint** |
| **1.** Target Directors | **1A.** Target Shareholders | **1Ai.** Identity of TS* |
| | | **1Aii.** Concert party arrangements |
| | **1B.** Fellow Target Director | **1Bi.** Failure to disclose information |
| | | **1Bii.** Merits of the bid |
| | | **1Biii.** Acting in concert with the Bidder |
| | | **1Biv.** Interest in bid |
| | **1C.** Bidder | **1Ci.** Breach of standstill clause |
| | | **1Cii.** Breach of confidentiality agreement |
| | | **1Ciii.** Failure to disclose information |
| | | **1Civ.** Conflict of interest |
| | | **1Cv.** Breach of timetable |
| | | **1Cvi.** Bidder pressured TS to sell shares |
| | | **1Cvii.** Extension of timetable |
| | | **1Cviii.** Takeover detrimental to long term plans of the TC** |
| | | **1Cix.** Breach of Code |
| | | **1Cx.** Misrepresented information |
| | | **1Cxi.** Value of bid |
| | | **1Cxii.** Failure to formalise bid |
| | | **1Cxiii.** Loss of employment |
| | | **1Cxiv.** Change to contract of employment |
| | 1D. Bidder/Government | **1Di.** Breach of competition laws |
| | | **1Dii.** TC is a ‘national treasure’ or ‘jewel company’ |
| | | **1Diii.** Takeover will have detrimental effect to UK economy |
| | 1E. Advisors | **1Ei.** Negligent advice |
| | 1F. Takeover Panel | **1Fi.** Decision or ruling |



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| | Complaint | |
|---|---|---|
| Complainant | Target of Complaint | Substance of Complaint |
| 2. Target Shareholders | 2A. Target Director | 2Ai. TD*** misrepresented information |
| | | 2Aii. Failure to disclose information |
| | | 2Aiii. TD in conflict or not complying with the Code |
| | | 2Aiv. TD valuation of the share price |
| | | 2Av. TD advice on the merits of the bid |
| | | 2Avi. TD interest in bid |
| | | 2Avii. TD knew or ought to have known that the advice given to the shareholders by other professionals was negligent or misrepresentative |
| | | 2Aviii. TD issued new shares |
| | | 2Aix. TD knew or ought to have known that bidder would strip company of assets |
| | | 2Ax. TD knew or ought to have known that the takeover was detrimental |
| | 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority |
| | | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted |
| | | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder |
| | | 2Biv. New directors/majority have stripped company of assets |
| | 2C. Advisors | 2Ci. Negligent advice |



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| | Complaint | |
|---|---|---|
| Complainant | Target of Complaint | Substance of Complaint |
| 3. Bidding Company | 3A. Target Company | 3Ai. Breach of timetable |
| | | 3Aii. TC used takeover defence |
| | | 3Aiii. TC used a disproportionate defence |
| | | 3Aiv. Failure to disclose information |
| | | 3Av. TD refused to negotiate |
| | | 3Avi. Value of bid |
| | | 3Avii. TD misrepresent information |
| | | 3Aviii. TD advice to shareholders |
| | 3B. Advisors | 3Bi. Negligent advice |
| | 3C. Takeover Panel | 3Ci. Decision or ruling |
| 4. Bidding Shareholders | 4A. Bidding Directors | 4Ai. Takeover is not in the best interests of the BC**** |
| | | 4Aii. BD did not obtain best price for shares |
| | | 4Aiii. BD misrepresented information |
| | | 4Aiv. BD advice on merits of bid |
| | | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative |
| | 4B. Advisors | 4Bi. Negligent advice |

*TS = Target Shareholder

**TC = Target Company

***TD = Target Director

****BC = Bidding Company

*****BD = Bidder Director

### 4.2.1 Explanations

1Aii (Concert Party Arrangements)

A concert party is a group of people acting together in a takeover bid.



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1Ci (Standstill Clause)

The target company and bidder can agree to a standstill clause, which generally means that the bidder will agree not to buy any further shares in the company (than they already own) without first receiving permission from the target board of directors.

1Bi, 1Ciii, 2Aii, 3Aiv (Failure to Disclose Information)

The meaning of information in this context is any information that would be relevant in deciding upon the merits of the bid. For example, a director could fail to disclose to the shareholder any interest they have in the transaction.

1Civ, 1Eii, 2Aii, 2Cii (Conflict of Interest)

A conflict of interest can arise when a target director has any interest in the outcome of the takeover bid which conflicts with the best interests of the company. For example, a target director may have made a deal with the bidder to keep their position in the company once the takeover was completed, or to receive another benefit, in exchange for their support. Conflicts of interest can also arise when a party has received an advantage which would lead to the process of the takeover being unfair. For example, a bidder may receive or have information that would help them succeed in the takeover bid. Advisors may also be in a position where a conflict of interest would arise, for instance a firm of solicitors could have professional ties to both the target company and the bidder, and as such may have information that would be relevant and valuable to the bid.

1Dii (National Treasure or Jewel Company)

Directors may believe that their company is important to the UK and is therefore a 'jewel company' or 'national treasure'. A company may be considered a jewel company if it significantly contributes to the economy. If a company has historical significance in the UK it may also be considered a national treasure. For example, a company which has been at the centre of the economy and popular with UK customers for a long period of time may be considered as having either of these titles.



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2Aviii (Issue of New Shares)

This complaint refers to any tactical dilution of shares in order to give the bidder a better chance of succeeding in a bid attempt, or to water down shares of other independent shareholders once the bid has been completed.

2Aiv (Target Directors Valuation of Share Price)

Generally if shareholders do not agree with the share price valuation they will not sell to the bidder. However, they may wish to sell their shares to the bidder but want to do so at a higher price and therefore want the target directors to negotiate an increased premium. If the target directors refuse to do so it may lead the shareholders to disagree and split into groups, those of whom may just simply decide to sell at that price if they believe that they will not get offered more, and those who may have to simply sell because the first group did, in order to avoid becoming minority shareholders. The second group may then feel that their shares were undervalued but were forced to sell despite disagreeing with the price offered.

2Biii (Unable to Take Advantage of Sell-Out Rule)

Shareholders who are still members of the company post-takeover may be affected by a new majority and want their shares to be bought by the bidder but are unable to take advantage of the sell-out rule. This is possible if the shareholders did not sell initially because they were unsure whether the bid would succeed (a bid needs only 50 percent of the shares to be successful, but 90 percent is required to take advantage of the sell-out rule).

**4.3 Causes of Action**

By identifying the substance of the parties' takeover complaints the potential legal causes of action that could form the basis of takeover litigation can be established. The table below shows these potential causes of action beside the original complaint. It is interesting to note that some complaints do not seem to have a legal cause of action. Most of the complaints can nevertheless be litigated using sections from the CA, most notably via directors' duties under s.171 to s.177. There are however other pieces of legislation and common law precedent



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which can form the basis of litigation. These are non-directors common law fiduciary duties, breach of contract, FTA, MA and FSMA. These causes of action were discussed and explained in the chapter three.

**Table 4.2**

| **Complaint: Complainant: Target Directors** | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 1A. Target Shareholders | 1Ai. Identity of TS | s.793, s.803 CA 2006 |
| | 1Aii. Concert party arrangements | s.793, s.803 CA 2006 |
| 1B. Fellow Target Director | 1Bi. Failure to disclose information | Duty of care; s.172, s.174 CA 2006 |
| | 1Bii. Merits of the bid | Duty of care; s.172, s.174 CA 2006 |
| | 1Biii. Acting in concert with the Bidder | Duty of care; s.172, s.173, s.174, s.175, s.177 CA 2006 |
| | 1Biv. Interest in bid | Duty of care; s.172, s.173, s.174, s.175, s.176, s.177 CA 2006 |
| 1C. Bidder | 1Ci. Breach of standstill clause | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) |
| | 1Cii. Breach of confidentiality agreement | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) |
| | 1Ciii. Failure to disclose information | |
| | 1Ciii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests |
| | 1Civ. Breach of timetable | |
| | 1Cv. Bidder pressured TS to sell shares | |
| | 1Cvi. Extension of timetable | |
| | 1Cvii. Takeover detrimental to long term plans of the TC | |
| | 1Cviii. Breach of Code | |
| | 1Cix. Misrepresented information | s.2(1) MA |
| | 1Cx. Value of bid | |
| | 1Cxi. Failure to formalise bid | |
| 1D. Bidder/Government | 1Di. Breach of competition laws | s.75 FTA |
| | 1Dii. TC is a ‘jewel company’ | |



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| | | |
|---|---|---|
| | 1Diii. Takeover will have detrimental effect to UK economy | |
| 1E. Advisors | 1Ei. Negligent advice | Duty of care; negligent misrepresentation |
| | 1Eii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests |
| 1F. Takeover Panel | 1Fi. Decision or ruling | Judicial Review |

| **Complaint: Complainant: Target Shareholders** | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 2A. Target Director | 2Ai. TD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 |
| | 2Aii. Failure to disclose information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 |
| | 2Aiii. TD in conflict or not complying with the Code | |
| | 2Aiv. TD valuation of the share price | |
| | 2Av. TD advice on the merits of the bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 |
| | 2Avi. TD interest in bid | Derivative claim for breach of directors duties (s.172, s.173 s.174, s.175, s.176, s.177 CA 2006); Part 26; s.994 CA 2006 |
| | 2Avii. TD knew or ought to have known that the advice given to the shareholders by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 |
| | 2Aviii. TD issued new shares | Derivative claim for breach of directors duties (s.171 CA 2006), s.33, s.549 CA 2006 |
| | 2Aix. TD knew or ought to have known that bidder would strip company of assets | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |



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| | | |
|---|---|---|
| | 2Ax. TD knew or ought to have known that the takeover was detrimental | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority | |
| | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted | s.549 CA 2006 |
| | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder | |
| | 2Biv. New directors/majority have stripped company of assets | s.911B CA 2006 |
| 2C. Advisors | 2Ci. Negligent advice | Duty of care; negligent misrepresentation |
| | 2Cii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests |

| **Complaint: Complainant: Bidding Company** | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 3A. Target Company | 3Ai. Breach of timetable | |
| | 3Aii. TC used takeover defence | |
| | 3Aiii. TC used a disproportionate defence | |
| | 3Aiv. Failure to disclose information | Duty of care; s.90A FSMA |
| | 3Av. TD refused to negotiate | |
| | 3Avi. Value of bid | |
| | 3Avii. TD misrepresent information | |
| | 3Aviii. TD advice to shareholders | |
| 3B. Advisors | 3Bi. Negligent advice | Duty of care; negligent misrepresentation |
| 3C. Takeover Panel | 3Ci. Decision or ruling | Judicial Review |



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| Complaint: Complainant: Bidding Shareholders | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 4A. Bidding Directors | 4Ai. Takeover in not in the best interests of the BC | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 4Aii. BD did not obtain best price for shares | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 4Aiii. BD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 4Aiv. BD advice on merits of bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 |
| 4B. Advisors | 4Bi. Negligent advice | Duty of care; negligent misrepresentation |

Once the potential legal causes of action had been identified a search could then be undertaken to find takeover litigation using the provisions as a starting point for the search. It is essential to note here that some of these causes of action can be brought using a derivative claim under s.260 CA, which is not a cause of action in of itself but a way of advancing some of the complaints and causes of action identified. A distinction between the substances of a claim, (i.e. the complaint), must be made from the procedural form, (i.e. whether the claim will be brought as a derivative action). For the purposes of this search, unfair prejudice has been listed as a cause of action. This is because it is essentially a claim which alleges that the company has been run in an unfairly prejudicial manner.[276] Even though the unfair prejudice provisions give the complainant a procedural form in which to pursue the complaint as litigation it is still a specific complaint in itself, whereas a derivative action is a procedure in which to advance other complaints, largely those relating to a breach of a director's duty.

A breach of a director's duty is a cause of action under which many of the above complaints can be brought. Only the company, however, may bring a claim for a breach of these duties, because they are only owed to the company.[277] Claims brought by a company are very often retrospective and are brought by members of the existing board usually for the actions of

[276] S.994 CA
[277] S.170(1) CA



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dismissed directors. If a breach is established the company can seek an injunction to stop the director from carrying out or continuing with the breach; damages by way of compensation where the director has been negligent; restoration of the company's property; voiding a contract; or rescinding a contract in which the director had an undisclosed interest.[278] An unfair prejudice claim is on the other hand an action which is brought by shareholders in order to directly benefit them for a wrong committed to them.[279]

## 4.4 Method of Search

The search that was undertaken to find all instances of litigation in respect of those causes of action as identified in Table 4.2 above. This section will now outline the method used for this search and more interestingly reveal the results the search generated.

As explained above, before beginning the search, the possible complaints that the parties to a takeover might have were listed. From this list, the legal causes of action in which these complaints could be brought as litigation were identified. The causes of action then became the basis of the search, however first a few issues, which are listed below had to be clarified.

### 4.4.1 Reported Versus Non-Reported Cases

The search was limited to cases which generated a reported decision. The reason for this limitation was that the time constraints of this project prevented a deeper search. There is therefore the possibility that beneath the tip of a few reported cases lays a hidden iceberg of litigation which was abandoned before a judgment was produced by the court. To try to address this remote possibility, informal interviews with practitioners were conducted. See appendix one for the completed interviews, which confirmed that takeover litigation in practice is very rarely undertaken or even threatened.

[278] S.178 CA
[279] S.994 CA



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#### 4.4.2 Cases Recorded Since 1960

Cases were examined from 1st January 1960, in order to give an extensive view of the cases brought over a long period of time. It also seemed futile to search before this point since takeovers were not abundant prior to this date.

#### 4.4.3 Jurisdictions

Excluded from the search were cases from Scotland and Commonwealth countries such as New Zealand and Australia. This is simply because the focus of this chapter is the laws of England and Wales.

#### 4.4.4 Substance of Claim

The cases which were of interest involved a takeover by either a scheme of arrangement, takeover offer, or any case in which there was a change of control or threat of a change of control. Both friendly and hostile takeovers were counted, and also claims brought either during or after the takeover. This is to enable a good overview of the litigation which can be brought during the whole of the takeover process including the effects of a takeover.

#### 4.4.5 The Search

Using the LexisNexis Professional internet database, a search was undertaken in June 2015, initially by searching against each cause of action, for example, s.171 CA. Once this search was completed, a case search was undertaken in order to seek out cases under the causes of action which did not have a relevant provision, such as the common law duty of care. Old common laws which are now codified in provisions of the CA were also searched for, such as the equivalent common law principle for s.171 of the CA which is the improper purpose doctrine. Defunct legislation was also searched when there was an identical provision that existed during the time period looked at, for example s.459 of the Companies Act 1985 has now been replaced by s.994 CA.



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These case searches however brought up many cases that were not relevant. In order to find those cases which involved takeover litigation, each case was examined individually. In some instances this was not possible to do with the initial search term (which was the cause of action). Therefore some searches were refined by selecting the company law field, and then searching within the results using the term "takeover." Once the whole search was complete, each case that had been found was then examined further using the case history function. This function allows the cases which had referred to the judgment of the relevant case to be shown, and also the cases which the relevant case had used in its judgment. Each relevant case was then checked to ensure that all the pertinent cases had been found. This search was also undertaken again in November 2016 to identify litigation that might have occurred since the original search.

### 4.5 The Findings

Between 1960 and 2016 there were 43 cases reported.[280] Table 4.3 below displays the number of cases litigated for each provision or principle that was searched.

**Table 4.3**

| | Cause of Action | No of Cases Litigated |
|---|---|---|
| **Companies Act 2006** | s.33 | 0 |
| | s.171 | 0 |
| | s.172 | 1 |
| | s.173 | 0 |
| | s.174 | 0 |
| | s.175 | 0 |
| | s.176 | 0 |
| | s.177 | 0 |
| | s.549 | 0 |
| | s.793 | 1 |
| | s.803 | 0 |
| | Part 26 | 1 |

[280] A full list of these cases can be found in appendix two



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| | | |
|---|---|---|
| | s.911B | 0 |
| | s.994 | 3 |
| **Companies Act 1985** | s.216 | 3 |
| | s.459 (s.994 CA06) | 4 |
| **Companies Act 1948** | s.164/172 | 1 |
| | s.209 | 2 |
| **Fair Trading Act 1973** | s.75 | 1 |
| **Misrepresentation Act 1967** | s.2(1) | 1 |
| **Financial Services and Markets Act** | s.90 | 0 |
| **Contract Law (common law)** | Breach of contract | 1 |
| | Negligent misstatement | 4 |
| **Directors Duties (common law position pre Companies Act 2006)** | Improper purpose | 4 |
| | Duty to act in good faith | 3 |
| | Duty of Care | 0 |
| | Conflict of interest | 0 |
| **Fiduciary Duties (common law)** | Duty of care | 5 |
| | Duty to act in best interests | 0 |
| | Duty of confidence | 2 |
| | Conflict of interest | 3 |
| **Judicial Review** | | 3 |
| **Total (inc. common law directors duties)** | | 43 |

* Common Law Fiduciary Duties are duties which arise from certain relationships (for example between a company and an accountant). They are not duties owed by directors specifically.



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### 4.5.1 Common Causes of Action

**Table 4.4**

| Cause of Action | Number of Takeover Litigation | Percentage of total cases recorded % |
|---|---|---|
| Common Law Fiduciary Duties | 10 | 23 |
| Directors Duties | 8 | 19 |
| Unfair Prejudice (s.994 CA06 & s.459 CA85) | 7 | 16 |
| Negligent Misstatement | 4 | 9 |

Table 4.4 shows the most popular causes of action and demonstrates that the most popular basis was the breach of a common law fiduciary duty. There were 10 cases alleging a breach of a fiduciary duty against non-directors (and one claim which alleged directors had breached a common law fiduciary duty owed to the shareholders)[281] which represents 36 percent of the cases overall. The most frequent fiduciary breach that was litigated was that of the duty of care, which totalled five of the 10 cases. Unsurprisingly, a majority of the cases were brought as an action against a director for a breach of their duties. Only one of the eight cases had been brought under the directors' duties provisions in the CA (this was s.172 duty to promote the success of the company). The rest of the cases were brought under the old common law directors' duties which existed prior to the 2006 Act. Out of these cases, five were for the breach of the proper purpose doctrine, and three were brought as a breach of the directors' duty to act in good faith. A possible explanation for the abundance of claims recorded under the old common law directors' duties may simply be that there was a longer period of time sampled for these duties, than for the provisions which have only come into force in the last 10 years. Unfair prejudice claims totalled 16 percent of the cases brought and negligent misstatement claims amounted to nine percent.

[281] See Sharp and others v Blank and others [2015] All ER (D) 171 (Nov)



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### 4.5.2 Propensity to Litigate

**Table 4.5**

| Year | Number of Takeover Litigation | Number of Takeovers | Percentage % |
|---|---|---|---|
| 2015 | 0 | 49 | 0 |
| 2014 | 2 | 211 | 0.95 |
| 2013 | 1 | 326 | 0.31 |
| 2012 | 0 | 373 | 0 |
| 2011 | 1 | 564 | 0.18 |
| 2010 | 1 | 537 | 0.19 |
| **Total** | **5** | **2060** | **0.24** |

* Figures for the number of takeovers (domestic) per year are taken from the Office for National Statistics.[282]

The data above demonstrates that takeover litigation occurs in less than one percent of completed takeovers in the UK. In a five year period from 2010 to 2015 only five claims were commenced out of 2060 transactions in the same period. If we also take into account the number of uncompleted takeovers then the rate of litigation falls further still.[283] Unfortunately, there is no available data to indicate the number of these uncompleted takeovers to confirm the exact rates.

**Table 4.6**

| Decade | Number of Takeover Litigation |
|---|---|
| 60's | 4 |
| 70's | 4 |
| 80's | 10 |
| 90's | 11 |
| 00's | 8 |
| 10's | 6 |
| **Total** | **43** |

[282] Office of National Statistics, Merger and Acquisitions <http://www.ons.gov.uk/businessindustryandtrade/changestobusiness/mergersandacquisitions/bulletins/mergersandacquisitionsinvolvingukcompanies/previousReleases> accessed 10 August 2015
[283] The recorded litigation cases included both completed and uncompleted takeovers.



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**Figure 4.1**

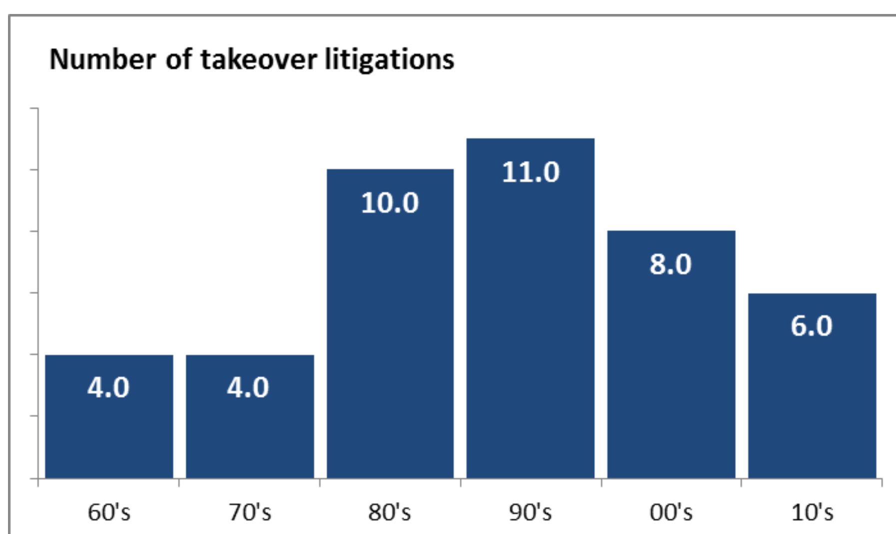


Table 4.5 illustrates that the number of cases increased significantly from four cases in the 1960's and the 1970s' to 10 in 1980's, and 11 cases in the 1990's. The decade of the 1990's showed a small peak in takeover litigation in the UK. From the 1980's to 2009 there has been a steady state of takeover litigation, with an average of around 10 takeover cases per decade. It is likely, looking at the data in Table 4.5 that this trend will continue in the next decade, as there have already been six cases from 2010 to 2015.

### 4.5.3 Instigator and Target of Litigation

**Table 4.7**

| Instigator of Litigation | Number | Percentage % |
|---|---|---|
| Target Shareholder | 17 | 39.6 |
| Target Company | 6 | 14 |
| Target Director | 0 | 0 |
| Bidder | 15 | 34.8 |
| Other | 5 | 11.6 |



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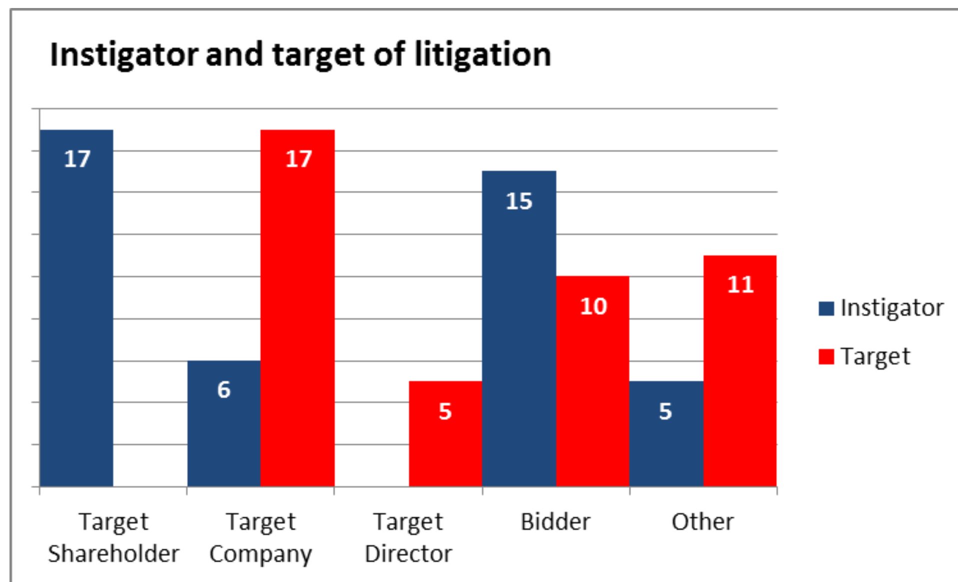
**Table 4.8**

| Target of Litigation | Number | Percentage % |
|---|---|---|
| Target Shareholder | 0 | 0 |
| Target Company | 17 | 39.6 |
| Target Director | 5 | 11.6 |
| Bidder | 10 | 23.2 |
| Other | 11 | 25.6 |

**Figure 4.2**




The group who instigated the most takeover litigation in the UK, within the cases recorded, were the target shareholders. Out of 43 cases the target shareholders initiated 17 of these claims which totalled almost 40 percent. This is closely followed by the bidder, who instigated 15 of the claims recorded. The rest of the claims were brought by the target company, who instigated six of the cases, or by other parties such as the Secretary of State, who began four of the cases. The target directors did not bring any individual claims on behalf of themselves, an example of which would be severance of employment terms. As noted above target directors complain on behalf of the target company. This particular search is not looking at personal claims a target director may bring on behalf of themselves**.** If they were involved in instigating the claim it was on behalf of the target company.



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The focus of the majority of the litigation was the target company, as 17 cases out of the 43 recorded were brought against the target company. This represents just under 40 percent of the litigation overall. This finding makes sense considering that the main instigators were the target shareholders and the bidder. The cases recorded generally involved the target company being sued for alleged wrongdoings during the process of the takeover. The next group of targets of litigation was the "others" category, who attracted 11 cases of the 43 recorded. This group included advisors, such as accountants and other bodies such as the Panel. The bidder was the target of nine of the cases, and the target directors were sued in five of the cases. The target directors were named as the main defendants in these cases due to an individual wrongdoing in which they could be found personally liable.

The reasons for instigating the litigation were varied and numerous, for example the target directors actions fell outside of powers;[284] the target company would not lift restrictions on the shareholder/bidder from buying further shares in the company;[285] the offer proposed during the scheme of arrangement was unfair, but the target company notified minority shareholders with an intention to acquire shares despite this;[286] the target company agreed not to co-operate with the rival bidders, and then did;[287] the advisors prepared misleading accounts;[288] the target shareholders were dissatisfied with how the takeover had been conducted;[289] a target director was bribed by the bidder;[290] a rival bidder agreed with the original bidder that they would withdraw their bid, and then did not;[291] the target company undervalued their own shares;[292] and the target directors exerted pressure on shareholders in order to achieve the bid.[293]

[284] Eclairs Group Ltd and another v JKX Oil and Gas plc and others [2013] All ER (D) 17 (Sep)
[285] Re Ricardo Group plc (No 3) [1989] BCLC 771; Re Geers Gross plc [1988] 1 All ER 224
[286] In re Grierson, Oldham & Adams Ltd [1967] 1 All ER 192; In re Bugle Press [1960] 3 WLR 956
[287] Dawson International plc v Coats Paton plc and Others [1989] BCLC 233
[288] Morgan Crucible Co plc v Hill Samuel Bank Ltd and others [1991] 1 All ER 148; Caparo Industries plc v Dickman and Others [1990] 1 All ER 568
[289] Gething v Kilner [1972] 1 All ER 1166
[290] Amalgamated Industrials Ltd and others v Johnson & Firth Brown Ltd 1980 A No 3937
[291] British and Commonwealth Holdings plc v Quadrex Holdings Inc[1989] 3 All ER 492
[292] Arbuthnott v Bonnyman and others [2015] All ER (D) 218 (May); Rock Nominees Ltd v RCO (Holdings) plc (in liquidation) and others [2004] 1 BCLC 439
[293] Re Astec (BSR) plc [1998] 2 BCLC 556



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### 4.5.4 Outcome of Litigation

**Table 4.9**

| | Number | Percentage % |
|---|---|---|
| **Litigation Successful** | 12 | 28 |
| **Litigation Unsuccessful** | 31 | 72 |

Table 4.9 illustrates that out of the 43 cases recorded only 12 were successful. 72 percent of the claims that were brought were unsuccessful. This means that the claimant did not achieve the outcome they desired, such as an injunction or remedies such as the mandatory buying or selling of shares. The types of litigation that were successful were very different, and therefore it would be difficult to ascertain what type of claim would succeed or not. It seems to very much depend on the individual claim and the facts surrounding the circumstances of the litigation.

A number of successful claims, however, involved allegations that the director was acting outside of their powers.[294] An example of this is the case of Howard Smith v Ampol.[295] Two companies, Ampol and Bulkships, held 55 percent of the issued shares of another company, which required more capital (Millers). Ampol made an offer for all the issued shares of Millers, and another company, Howard Smith, announced an intention to make a higher offer for those shares. Miller's directors considered Ampol's offer too low and as such decided to recommend that the offer be rejected. Ampol and Bulkships then stated that they intended to act jointly in the future operations of Miller and would reject any offer for their shares. Howard Smith then applied to Miller for an allotment of four and a half million ordinary shares. Miller's directors subsequently decided by a majority to make the allotment and immediately issued the shares. The effect of that issue was that firstly, Miller's obtained the much needed capital; secondly, Ampol and Bulkship's shareholding was reduced to 36.6 percent of the issued shares. This consequently meant that Howard Smith was now in a position to make an effective takeover offer. Ampol however challenged the validity of the

[294] Eclairs Group (n284); Howard Smith Ltd (n243)
[295] ibid (Howard Smith)



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issue of the shares to Howard Smith and sought an order in the Supreme Court of New South Wales, Australia for the rectification of the share register by the removal of Howard Smith as a member of Miller's in respect of the allotted shares. Miller's directors contended that the primary reason for the issue of the shares to Howard Smith was to obtain more capital.

Other successful claims resulted in the lifting of a restriction to buy shares;[296] poison pill agreements being quashed;[297] the declaration that an offer was unfair;[298] that an agreement to withdraw a bid could be relied upon[299] and that the accounts of the target company which were relied upon to make a bid were misleading.[300] Although the successful claims do not demonstrate any sort of pattern, claims which were rarely successful, however were derivative or unfair prejudice claims.

### 4.5.5 Summary of Findings

It is clear from data collected that there is little to no litigation during or after a takeover in the UK. If litigation does take place the likely causes of action are common law fiduciary duties or breach of contract. This is because the main complaints pursued in takeover litigation are advisors' abuse of confidentiality or conflict of interest. Interestingly, whilst this litigation can have an indirect effect of frustrating the bid, it seems this is not the purpose for commencing these types of claims. There are very few claims which have been brought that frustrate a bid over the entire period looked at, in fact many of the claims were brought after the takeover had been completed. There are also a number of cases involving unfair prejudice claims, however as noted above, this litigation only benefits the shareholder who brings the claim as they are not suing so as to benefit others (as opposed to a derivative claim which benefits the company). The pursuit of this litigation may therefore be solely motivated by a direct personal benefit. It is therefore clear that the courts do not often affect the outcome of a takeover. As such the process of a takeover is rarely interrupted by litigation in the UK.

[296] Re Ricardo Group plc (n285)
[297] Criterion Properties plc v Stratford UK Properties LLC and others [2003] 2 BCLC 129
[298] Re Bugle Press (n286)
[299] British and Commonwealth holdings plc (n291)
[300] Yorkshire Enterprise Limited and another v Robson Rhodes [1998]



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### 4.6 The Code and Panel Decisions

Once the search had been completed, in respect of the legal causes of action available for parties to continue their complaints, it was interesting to compare these to the Code. Table 4.10 below enables us to see whether there is a parallel right to complain to the Panel, whether there is a right to complain to the Panel when there is no legal cause of action, and even more interestingly when parties to a takeover can neither pursue their complaint via litigation or a complaint to the Panel (which is rare).

**Table 4.10**

| **Complaint: Target Directors** | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 1A. Target Shareholder | 1Ai. Identity of TS | s.793, s.803 CA 2006 | Rule 5.4, Rule 8 |
| | 1Aii. Concert party arrangements | s.793, s.803 CA 2006 | Rule 9.1, Rule 8 |
| 1B. Fellow Target Director | 1Bi. Failure to disclose information | Duty of care; s.172, s.174 CA 2006 | Rule 20.1, Rule 23.1 |
| | 1Bii. Merits of the bid | Duty of care; s.172, s.174 CA 2006 | Rule 23.1, rule 20.1 |
| | 1Biii. Acting in concert with the Bidder | Duty of care; s.172, s.173, s.174, s.175, s.177 CA 2006 | Rule 16.2, Rule 24.5 |
| | 1Biv. Interest in bid | Duty of care; s.172, s.173, s.174, s.175, s.176, s.177 CA 2006 | Rule 16.2, Rule 24.5 |

| **Complaint: Target Directors** | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 1C. Bidder | 1Ci. Breach of standstill clause | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) | |
| | 1Cii. Breach of confidentiality agreement | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) | Rule 20 |
| | 1Ciii. Failure to disclose information | | Rule 8, Rule 20.1, Rule 23.1, Rule 24.2, Rule 24.3, Rule 25.3 |



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| | | | |
|---|---|---|---|
| | 1Ciii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests | Rule 3.2 |
| | 1Civ. Breach of timetable | | Rule 31 |
| | 1Cv. Bidder pressured TS to sell shares | | Rule 16.1 |
| | 1Cvi. Extension of timetable | | Rule 31 |
| | 1Cvii. Takeover detrimental to long term plans of the target company | | Rule 24.2 |
| | 1Cviii. Breach of Takeover Regulations | | Breach of any Code rule |
| | 1Cix. Misrepresented information | s.2(1) MA 67 | Rule 19.1, 19.3 |
| | 1Cx. Value of bid | | |
| | 1Cxi. Failure to formalise bid | | Rule 2.7 |
| 1D. Bidder/Government | 1Di. Breach of competition laws | s.75 FTA 73 | |
| | 1Dii. TC is a 'national treasure' or 'jewel company' | | |
| | 1Diii. Takeover will have detrimental effect to UK economy | | |
| 1E. Advisors | 1Ei. Negligent advice | Duty of care; negligent misrepresentation | |
| | 1Eii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests | |
| 1F. Takeover Panel | 1Fi. Decision or ruling | Judicial Review | |



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| Complaint: Target Shareholders | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 2A. Target Director | 2Ai. TD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 | Rule 19.1, 19.3 |
| | 2Aii. Failure to disclose information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 | Rule 23.1, Rule 20.1 |
| | 2Aiii. TD in conflict or not complying with the Code | | A number of Code rules could be breached |
| | 2Aiv. TD valuation of the share price | | Rule 3.1 |
| | 2Av. TD advice on the merits of the bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | Rule 23.1, Rule 20.1 |
| | 2Avi. TD interest in bid | Derivative claim for breach of directors duties (s.172, s.173 s.174, s.175, s.176, s.177 CA 2006); Part 26; s.994 CA 2006 | Rule 16.2, Rule 24.5 |
| | 2Avii. TD knew or ought to have known that the advice given to the shareholders by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | Rule 19.1, 19.3 |
| | 2Aviii. TD issued new shares | Derivative claim for breach of directors duties (s.171 CA 2006), s.33, s.549 CA 2006 | Rule 21 |
| | 2Aix. TD knew or ought to have known that bidder would strip company of assets | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Rule 23.1 |
| | 2Ax. TD knew or ought to have known that the takeover was detrimental | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Rule 23.1 |



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| Complaint: Target Shareholders | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority | | |
| | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted | s.549 CA 2006 | |
| | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder | | |
| | 2Biv. New directors/majority have stripped company of assets | s.911B CA 2006 | |
| 2C. Advisors | 2Ci. Negligent advice | Duty of care; negligent misrepresentation | |
| | 2Cii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests | |

| Complaint: Bidding Company | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 3A. Target Company | 3Ai. Breach of timetable | | Rule 31 |
| | 3Aii. TC used takeover defence | | Rule 21 |
| | 3Aiii. TC used a disproportionate defence | | Rule 21 |
| | 3Aiv. Failure to disclosure of information | Duty of care; s.90A FSMA 2000 | Rule 8, Rule 20.1, Rule 25.3 |
| | 3Av. TD refused to negotiate | | |
| | 3Avi. Value of bid | | |
| | 3Avii. TD misrepresent information | | |
| | 3Aviii. TD advice to shareholders | | |



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| 3B. Advisors | 3Bi. Negligent advice | Duty of care; negligent misrepresentation | |
|---|---|---|---|
| 3C. Takeover Panel | 3Ci. Decision or ruling | Judicial Review | |

| **Complaint: Bidding Shareholders** | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 4A. Bidding Directors | 4Ai. Takeover in not in the best interests of the BC | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | |
| | 4Aii. BD did not obtain best price for shares | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | |
| | 4Aiii. BD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | |
| | 4Aiv. BD advice on merits of bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | |
| | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | |
| 4B. Advisors | 4Bi. Negligent advice | Duty of care; negligent misrepresentation | |

As shown in Table 4.10 there are some complaints which neither have a legal cause of action, nor a specific Code provision, in which to pursue the complaint with the court or the Panel. These complaints are generally those surrounding the merits of the takeover, for example when the takeover is not in the best interests of the company's future plans. The fact that a takeover cannot be prevented on grounds related to the merit of the takeover may seem odd however the Code is built around the principle that target shareholders are, as the owners of the company, the only party who should decide on the merits of the bid.[301] They make their

[301] The Code, para 2(a) and General Principle 3



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decision by either deciding to sell their shares or not. How they decide what the merits of the bid are, and subsequently whether to sell, will be considered by each individual shareholder. They may for instance consider the effect of the takeover on the future of the company's plans or its stakeholders, or they may also make their decision by considering the value offered for their shares. Some would therefore argue that a right of action to continue a claim regarding the merits of the takeover is unnecessary or contrary to the provisions of the Code. As can be seen above however a target director and the bidder both have duties which they must do, such as disclosing certain information, so that a shareholder can make this decision. These are duties which, if not done correctly, can be pursued by parties via litigation.

Those complaints which do not have a legal cause of action, but can be pursued via the Panel's system, are generally those surrounding the process of the actual takeover (i.e. timetable for offer) or the conduct of the parties involved (i.e. disclosure requirements or use of frustrating actions). A number of complaints do have a corresponding right of action which a party can pursue via the courts. However whether these legal rights can be pursued will be subject to the no frustration principle (and other company law provisions), and therefore even though there is a cause of action the party (specifically the target company) may not actually be able to commence litigation. This is discussed in more detail in chapter seven.

It is interesting here to be able to identify which complaints can be pursued via the court, the Panel, by both or by none. It is also interesting to identify how many decisions the Panel makes regarding these complaints. It must be noted, firstly however, that the Panel deals with a large number of queries and complaints on a daily basis, and the decisions shown below are those cases in which the Panel has made a ruling. There is no data available which details the number of decisions the Panel makes informally on a daily basis. It could be argued, however that those complaints which received a ruling are equal to those complaints which if litigated would actually reach the courts, and is therefore more suitable data in which to make a comparison with the legal cases recorded in the previous sections.

Table 4.11, below, shows the number of rulings the Panel has made in respect of the Code provisions outlined in Table 4.10.



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**Table 4.11**

| Code Rule | Rulings* |
|---|---|
| 2.7 | 22 |
| 5.4 | 0 |
| 8 | 1 |
| 9.1 | 3 |
| 16.1 | 0 |
| 16.2 | 0 |
| 19.1 | 0 |
| 19.3 | 1 |
| 20 | 0 |
| 20.1 | 0 |
| 21 | 0 |
| 23.1 | 0 |
| 24.5 | 0 |
| 25.3 | 0 |
| 31 | 0 |
| **Total** | **27** |

From the period of 2010 to 2015 there have been a total of 27 rulings made on the provisions of the Code as identified in Table 4.10. In the same period there were only five claims brought before the court as shown in Table 4.5. Based on these data there are five times more rulings made by the Panel than by the courts regarding the takeover complaints identified above.

The most frequent issue the Panel rules upon was Rule 2.7 (for which they have made 22 rulings out of the 27 concerning this complaint). Rule 2.7 of the Code requires the bidder to make a firm intention to put forward an offer to the target company. The other provisions the Panel has made rulings regarding are Rule 8 which concerns disclosure; Rule 9.1 which is in relation to concert parties; and Rule 19.3 which requires the clarification of a statement, for example when information may have been misrepresented. The Rules of the Code that have been outlined above correspond to the list of complaints identified in Table 4.10 however they are not exhaustive of the Rules that the Panel has made decisions regarding.



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Table 4.13 below shows the number of rulings made by the Panel in total (including the figures from Table 4.11 and 4.12) each year since 2010.

**Table 4.12**

| Year | No of Rulings |
|---|---|
| 2015 | 0 |
| 2014 | 2 |
| 2013 | 3 |
| 2012 | 5 |
| 2011 | 14 |
| 2010 | 11 |
| **Total** | **35** |

Table 4.14 shows how these rulings compare with the number of takeovers completed in each year.

**Table 4.13**

| Year | No of Rulings | No of Takeovers | Percentage % |
|---|---|---|---|
| 2015 | 0 | 49 | 0 |
| 2014 | 2 | 211 | 0.95 |
| 2013 | 3 | 326 | 0.92 |
| 2012 | 5 | 373 | 1.34 |
| 2011 | 14 | 564 | 2.48 |
| 2010 | 11 | 537 | 2.05 |
| **Total** | **35** | **2060** | **1.75** |

Overall, rulings by the Panel are made on less than two percent of completed takeovers. Although this number is small it is still an increase upon the small percent of takeovers which experience litigation. As such, the Panel makes six times more rulings than the court makes decisions regarding takeover litigation. When considered together there are approximately two percent of takeovers which involve either litigation or a Panel ruling. This means that interference to the takeover process in the UK is relatively rare. There is neither a propensity to litigate, nor to seek or require the Panel to make a formal ruling. From the small numbers seen the Panel, whilst more active than the courts in settling takeover disputes, does not seem



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to be dealing with a large number of cases. It should also be noted however, that the Panel are contacted on a daily basis to give informal guidance and rulings on complaints.

### 4.7 Conclusion

The findings of the search established that less than one percent of "takeover litigation" is brought in the UK. The amount of litigation does not seem to have increased or decreased in the last three decades, and therefore remains steady. The main instigators of the litigation are the target shareholders and the bidders, and the claims are usually against the target company. The most popular causes of action in which to pursue takeover litigation are breaches of director's duties, unfair prejudice under s.994 CA, negligent misstatements and breach of common law non-directors fiduciary duties. The litigation brought is however rarely successful, as 71 percent of claims fail to give the claimant their desired outcome. The Panel delivers decisions in less than two percent of takeovers. This figure is slightly more than the amount of takeover litigation brought but is still not a significant amount. It can therefore be concluded that there is not a propensity to litigate during or after a takeover in the UK by the main parties to a takeover.



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## Chapter Five

## US Takeovers: Practices and Regulation

### 5.1 Introduction

The preceding chapters described the regulation of takeovers in the UK and mapped its litigation landscape. This chapter will now turn to describing the US regulation of takeovers, which is very different from the regulation of takeovers in the UK. One of the main differences is that corporations in the US, particularly those that are held publicly, function in a dual regulatory system, which is the combination of federal securities law and state corporate law.[302] Both state and federal law play very important regulatory roles. The way in which takeovers are completed in the US is also very different. In the UK there is the takeover offer and the scheme of arrangement, but in the US single and two step mergers are used.

This chapter offers a description of the practices of takeovers in the US, including a discussion of the key players and their competing interests, and will give an outline of the US regulatory regime. Section 5.2 will describe the process by which takeovers are completed in the US. Sections 5.3 and 5.4 will then describe the federal and state laws which regulate US takeovers.

### 5.2 US Practices: Single-Step Mergers and Two-Step Mergers

There are at least five major ways of acquiring control of a corporation in the US: via a single-step merger; a two-step merger using the tender offer; purchase of all or substantially all of the target's assets; a proxy contest; and negotiated or open market stock purchases.[303] These methods can be distinguished by whether they are statutory or non-statutory acquisition techniques: the former includes the merger and its variants, and the sale of all or substantially all corporate assets; the latter includes the proxy contest, the tender offer and

[302] Stephen M Bainbridge, *Mergers and Acquisitions* (3rd Edition, Foundation Press 2012) 4
[303] ibid 16



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stock purchases.[304] Statutory forms of takeovers require approval of the target board, whilst the non-statutory techniques do not.[305] This distinction can be made between the takeover offer and takeover scheme of arrangement in the UK. Whilst the scheme of arrangement requires the boards of directors to agree to the takeover, the takeover offer does not. The focus of this chapter however will be the "single-step merger," in which the bidder requests the approval of the target shareholders to acquire 100 percent of the shares of the target company, similar to the scheme of arrangement approach in the UK; and the two-step merger using a tender offer, in which a bidder can make an offer directly to target shareholders to purchase their shares, and then follow the tender offer with a "two-step merger" to eliminate minority shareholders. This is the equivalent of the UK's takeover offer, followed by the use of the squeeze out rights. Another tactic that can be used to takeover a US company is stakebuilding. This involves a stake in a company being built up over time in order to make it easier for the shareholder to eventually commence a takeover. This tactic has become an increasingly popular method in the US to secure a takeover. This section will now discuss each approach in more detail.

### 5.2.1 Single-Step Merger

In a single-step structure (or statutory merger), no tender offer is made but instead the merger is submitted to a vote of the target's shareholders.[306] A single-step merger transaction always requires the approval of the board of directors of the target company, so it is not available if the acquirer is proceeding on an unsolicited (or hostile) basis.[307] A single-step merger will always assure that the bidder will receive 100 percent of the shares of the target company.[308] Transactions being done on an agreed basis that involve the use of bidder shares as consideration will normally be structured as a single-step merger.[309] The main characteristics of a single-step merger are almost identical to those of the scheme of arrangement. The key difference however is the absence of court approval in a single-step merger, unlike in the UK which requires the courts approval for a scheme of arrangement to become binding.

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[304] Bainbridge (n302) 16
[305] ibid
[306] See Delaware General Corporation Law §251; Model Business Corporate Act §11.07
[307] Richard Hall, *United States of America Takeover Guide* (Cravath, Swaine & Moore LLP 2014) 2
[308] ibid
[309] ibid



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If a bidder wishes to proceed by way of single-step merger, the bidder and the target company will begin to negotiate and then enter into a merger agreement.[310] Whether the bidder is proceeding by way of a single-step merger or tender offer, it is almost universal for the bidder and the target company to enter into a merger agreement (except in the case of a hostile takeover).[311] This agreement customarily sets forth the terms upon which the takeover will be completed. These agreements are tremendously advantageous to the bidder as the agreement will usually include favourable terms for the bidder should the target company change their mind about the merger. The terms can include any provisions agreed between the bidder and the target company regarding such matters as restrictions on the ability of the target company to solicit competing proposals, and the payment by the target company to the bidder of a termination fee in the event the takeover is not completed because a third party makes a competing offer.[312]

The agreement will also include covenants on the structure of the transaction, the conditions to the bidder's obligation to complete the takeover and the commitment of the board of directors of the target company to recommend the acquisition. The merger agreement for a single-step acquisition also typically includes covenants on the part of the target company to make the necessary SEC filings, complete the SEC clearance process and hold its shareholders' meeting as soon as reasonably practicable, and to consult with the acquirer about SEC filings, submissions, comments and other developments.[313] Subject to these contractual provisions, though, in a single-step transaction the process of preparing the key disclosure document and dealing with SEC comments is controlled by the target company.[314] For these reasons it would be impossible to complete a single-step merger without the co-operation of the target's board of directors.

Following the execution of the merger agreement, the parties (bidder and target) prepare proxy materials, which include all the information shareholders need in order to vote on the

[310] Bainbridge (n302) 17
[311] Hall (n307) 1
[312] ibid
[313] A Guide to Takeovers in the United States, Clifford Chance Guide (2010) <http://globalmandatoolkit.cliffordchance.com/downloads/A-Guide-to-Takeovers-in-the-US-Extract.pdf> accessed 15 October 2014, 16
[314] ibid



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proposed merger transaction, including terms of the deal and reasons why the target board is recommending the merger. Once the proxy materials have been finalised and sent to the shareholders this commences the proxy solicitation period. The bidder often engages the services of a proxy soliciting firm at this stage to assist them in this process.[315] In order to assure a favourable result, proxy solicitation firms typically recommend a solicitation period of at least 35 days before the shareholder meeting in which the proposed transaction will be voted upon.[316] Once the single-step merger has been voted upon by the shareholders at the meeting the decision becomes binding (this process does not require court approval, as is required in the UK). Below gives an idea of the general timeline of a single-step merger:

| **Single-Step Transaction** | |
|---|---|
| **Day(s)** | **Activity** |
| 1 | Announcement |
| 2 to 15 | Prepare proxy statement (Target with the Bidder's input) |
| 16 | File preliminary proxy materials with SEC |
| 26 to 50 | Receive and resolve SEC comments |
| 55 | Print and mail proxy materials |
| 90 | Target shareholders' meeting to vote on merger |
| 91 | Complete merger (provided requisite vote is obtained) |
| | *Bidder now controls and owns 100% of Target* |

*Data from 'A Guide to Takeovers in the United States', Clifford Chance Guide (2010)

Situations in which a single-step merger might be preferred over a two-step merger include: (i) when there are regulatory or other approvals that cannot be satisfied quickly (such as, antitrust approvals, or registration with the SEC if the consideration being offered to the target company's shareholders consists in whole or in part of shares of the acquiring company); (ii) when the bidding company is financing the transaction with loans and the lenders do not wish to provide bridge financing for the purchase of shares in a tender offer; (iii) when the transaction will include an equity roll-over by management or other target shareholders, and the bidder wishes to avoid the technical difficulties presented by the

[315] Bainbridge (n302) 17
[316] Guide to US Takeovers, Clifford Chance (n313) 16



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application of the SEC's rules to those kinds of arrangements; and (iv) when the target's board of directors wishes to expose the transaction to competing bids for a longer period of time than would be available in a two-step transaction.[317]

### 5.2.2 Two-Step Merger (Tender Offer)

There are a number of important variations on the basic tender offer theme. The two main variations are: a partial tender offer, which is for less than all of the target's outstanding shares that leaves minority shareholders in place; or a two-tier tender offer (or two-step merger) where the offer is designed to proceed in two steps and results in 100 per cent of the shares being obtained.[318] In a two-step structure, the merger agreement will provide for a tender offer to be made to the target company which is then followed by a two-step merger between the bidder and the target in order to "squeeze out" any remaining shareholders. In the tender offer, the bidder offers to buy any and all of the shares of the target that have been tendered before the expiration of the offer, provided the conditions to the offer are satisfied at that time.[319] Those offer conditions customarily include a sufficient number of shares having been tendered so that the bidder can vote through the two-step merger alone (without needing the votes of any other shareholders). The two-step merger is used to eliminate the shares not tendered in the tender offer by converting them into the right to receive the same amount of consideration per share that is paid in the tender offer.[320] Even if the two-step merger takes some time to complete, the acquirer controls the target company from the time it completes its tender offer.[321] In the US unsolicited or hostile transactions are nearly always structured as two-step mergers.[322]

The process of the two-step merger is similar to the UK's takeover offer, and therefore the parties to the bid will have very similar interests and goals. There is however a crucial difference between the two systems processes because directors in the US are generally free to use any pre or post bid defences to ward off unwanted takeovers. It is therefore much more

[317] Guide to US Takeovers, Clifford Chance (n313) 42-43
[318] Bainbridge (n302) 23
[319] Guide to US Takeovers, Clifford Chance (n313) 13
[320] ibid
[321] ibid
[322] Bainbridge (n302) 22-23



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difficult to succeed in a hostile bid situation in the US than in the UK. Additionally even if the takeover is on a friendly basis the target directors are able to tactically frustrate the bid, often to try and recover greater premiums for the target company's shares. Below gives an idea of the general timeline of a ("straight-forward," i.e. no frustrating action) two-step merger:

| **Two-Step Transaction** | |
|---|---|
| **Day(s)** | **Activity** |
| 1 | Announcement |
| 2 to 15 | Prepare Offer to Purchase and Schedule 14D-9 (Target) |
| 15 | Commence tender offer; file definitive tender offer materials with SEC; mail materials to Target Shareholders |
| 15 to 43 | Address any comments provided by SEC staff |
| 43 | Close tender offer (if minimum tender offer and other conditions satisfied) |
| | *Bidder now controls Target* |
| 47 | If Bidder now owns at least 90% of Target's outstanding shares - file short-form merger certificate |
| | *Bidder now owns 100% of Target* |
| 47 to 77 | If Bidder owns less than 90% of Target's outstanding shares - prepare and file proxy materials with SEC relating to "squeeze-out" merger |
| 88 | Mail proxy materials |
| 108 | Target shareholder meeting to vote on 'squeeze out' merger |
| 109 | Complete merger |
| | *Bidder now owns 100% of Target* |

*Data from 'A Guide to Takeovers in the United States', Clifford Chance Guide (2010)

### 5.2.3 Stakebuilding

It is becoming increasingly common in the US for bidders to make open-market or negotiated block purchases of a target company's shares before beginning negotiations with the target or before a negotiated transaction with the target is announced (these are sometimes called "toehold" purchases).[323] There are several possible reasons to pursue toehold purchases: firstly, such purchases are likely to be at a less expensive price per share than the transaction

[323] A Guide to US Takeovers, Clifford Chance (n313) 7



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price finally agreed with the target, thereby helping lower the total cost of the acquisition; secondly, if the acquirer is outbid by a third party, the profit on the toehold share position will help cover transaction costs that otherwise would be borne by the would-be acquirer; thirdly, a sizeable toehold might help defeat a competing bid; and finally, if the approach has the potential to turn hostile, the bidder may need to hold shares in order to have standing to sue the target or its board of directors.[324] This method is also known as a creeping tender offer, which does not involve an actual tender offer, the bidder will keep buying target shares on the open market or in privately negotiated block purchases until it has a controlling interest at which point a proxy contest to nominate a board favourable to the takeover can be elected by the bidder.[325] The bidder may then follow up with a freeze-out merger to eliminate remaining majority shareholders.[326] Unlike in the UK, there is no mandatory offer regime in the US requiring that a person, who acquires a specific percentage of shares in a target company, make an offer for the remaining shares. As such toehold purchases (even substantial ones) in the US will not trigger an obligation to make a follow-on offer. This concludes the discussion of the process of takeovers in the US; the next section will now turn to describe the system that regulates this process.

### 5.3 US Regulatory Regime: Federal Regulation of Takeovers

The regulation of takeovers in the US is governed both by federal and state law. The process of the takeover (i.e. how a bid should be made) is regulated principally by three pieces of federal legislation: the Securities Act of 1933,[327] the Securities and Exchange Act of 1934[328] (the "Exchange Act") and the Williams Act 1968.[329] These Acts are overseen by the Securities and Exchange Commission ("The SEC"), a regulatory body which assesses compliance with the disclosure and process rules, much like the Panel does in the UK. Managerial conduct within takeover bids is regulated primarily by state law and state courts,

[324] A Guide to US Takeovers, Clifford Chance (n313) 7
[325] Bainbridge (n307) 24
[326] ibid; (A freeze out merger is where a subsidiary has minority shareholders that the controlling shareholder wishes to force out and to sell their stock. A freeze-out is accomplished by merging the subsidiary with the parent or with a wholly owned subsidiary of the parent pursuant to a merger agreement by which the minority shareholders receive cash or securities of the parent in exchange for their shares: see Bainbridge (n307) 27)
[327] 15 United States Code § 77a-77z-3
[328] ibid § 78a-78mm
[329] ibid § 78a et seq



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which usually means Delaware's Chancery judges and the Delaware Supreme Court.[330] This is because Delaware serves as the state of incorporation for more companies, and more public companies, than any other state, and as such Delaware serves as the model for most corporate law in the US.[331]

Delaware's Court of Chancery is the forum where many, if not most, of the significant cases concerning corporate law have been litigated. There is a considerable body of case law interpreting the Delaware corporate statute, which allows legal questions to be answered with confidence.[332] The court therefore has a special expertise in corporate law and corporate governance issues, and because the case law concerning corporate control issues is not as well developed in other states, many states specifically look to Delaware case law as precedent for decisions in their own courts.[333] The court's decisions also tend to render decisions quite quickly; thereby facilitating transactions that are often time sensitive.[334] Delaware's cases are therefore the focus of any discussion regarding managerial conduct more generally, and more specifically during the process of a takeover bid. The focus of any discussion of state law will therefore focus on that of Delaware's State Law, unless stated otherwise.

The US Supreme Court has repeatedly held that federal securities laws do not pre-empt state corporate law, but instead place only a "limited gloss" on the broader body of state law.[335] Bainbridge notes that a fair rule of thumb is that state law is concerned with the substance of corporate governance, whilst federal law is concerned with disclosure and a limited number of procedural aspects of corporate governance.[336] This particular section will give a brief overview of the federal law that governs takeovers and section 5.4 will do the same for state law. The following will therefore give a brief description of federal law, an outline of the

[330] Armour, Skeel (n34) 1743
[331] See for example John Armour, Bernard Black, Brian Cheffins, 'Delaware's Balancing Act' (2012) 87 Indiana Law Journal 1345; Brian Cheffins, John Armour, Bernard Black, 'Delaware Corporate Litigation and the Fragmentation of the Plaintiff's Bar' (2000) 2 Columbia Business Law Review 428.
[332] Bainbridge (n302) 7
[333] Armour, Black and Cheffins (n331) 1381
[334] Bainbridge (n302) 7; see also Jill E Fisch, 'The Peculiar Role of the Delaware Courts in Competition for Corporate Charters' (2000) 68 University of *Cincinnati* Law Review 1061
[335] Bainbridge (n302) 10; CTS Corp v Dynamics Corporation of America 481 US 69 (1987); Burks v Lasker 441 US 471 (1979); Santa Fe Industries v Green 430 US 462 (1977)
[336] Bainbridge (n302) 10



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relevant federal acts and how they apply to the process of single and two step mergers, as well as stakebuilding.

### 5.3.1 Federal Law

In the US, federal laws generally apply to the whole of the US and its territories, and are created by Congress, who draft and pass proposed bills. These bills are then signed into law by the President. Federal courts may review these laws and remove them if they do not correspond with the US Constitution.[337] All the federal laws of the US, once passed, can be found within the US Codes, which is a consolidation and codification by subject matter of the general and permanent laws of the United States, and can be accessed online.[338] The Codes are prepared by the Office of the Law Revision Counsel of the United States House of Representatives. The Codes, however, do not include regulations issued by executive branch agencies (such as the SEC), decisions of federal courts, treaties, or laws enacted by state or local governments.[339]

The US takeover regime is often associated with a cluster of Delaware takeover cases in the 1980s; however the foundations of the regulation of takeovers were laid much earlier under federal law. The 1933 and 1934 Securities Acts were passed in the wake of the 1929 Crash and the early years of the Depression.[340] The Securities Act of 1933 regulates primary market sales of securities by issuing corporations.[341] The Exchange Act of 1934 regulates a number of transactions but is generally concerned with the trading of corporate securities on securities exchanges and other secondary markets.[342] Subject to certain exemptions, all corporations that sell securities to the public are subject to the Securities Act.[343] In contrast, the Exchange Act applies to a narrower range of business, although as Bainbridge notes, the Act has a complex set of rules for deciding which provisions apply to which corporations,

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337 Federal Laws and Regulations, USA.gov <http://www.usa.gov/Topics/Reference-Shelf/Laws.shtml> accessed 3 December 2014
338 Office of the Law Revision Counsel: United States Code <http://uscode.house.gov/> accessed 3 December 2014
339 Federal Laws and Regulations (n337)
340 Armour, Skeel (n34) 1752
341 Bainbridge (n302) 8
342 ibid
343 ibid fn 19



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however generally it applies only to publicly held corporations.[344] The Exchange Act also established the Securities and Exchange Commission to serve as the "principal policeman of the markets."[345] Whilst the various federal statutes are concerned with different transactions, they have the same basic purpose, which is to require corporations and other issues of securities to provide full disclosure to ensure that investors have all the information they need to make an informed decision about buying, selling, or voting securities; and to punish fraud committed in connection with securities transactions.[346] The next sections will give a brief outline of the content and purpose of these acts, and explain the framework and jurisdiction of the Securities and Exchange Commission (SEC).

#### 5.3.1.1 The Securities Act of 1933

The Securities Act of 1933 has two basic objectives: firstly it assures investors receive financial and other significant information concerning securities being offered for public sale; and secondly prohibits deceit, misrepresentations, and other fraud in the sale of securities.[347] A primary means of accomplishing these objectives is the disclosure of important financial information through the registration of securities.[348] This information enables investors to make informed judgments about whether to purchase a company's securities. Investors who purchase securities and then suffer losses have important recovery rights under this legislation, if they can prove that there was incomplete or inaccurate disclosure of important information.[349] The main provisions of this act that apply in a takeover setting are thus the registration requirements that relate to mergers and acquisition transactions, when the consideration to be received by the target's shareholders includes securities. Accordingly the act only applies when an issuer is actually selling securities, if a company can raise funds by other means, the Securities Act does not require it to provide any disclosures.[350] It instead

[344] Bainbridge (n302) fn 19
[345] Armour, Skeel (n34) 1752
[346] Bainbridge (n302) 8; Rubin v United States 449 US 424 431 (1981) ('These provisions were enacted to protect against fraud and promote the free flow of information in the public dissemination of securities')
[347] US Securities Exchange Commission, The Laws That Govern the Securities Industry <http://www.sec.gov/about/laws.shtml> accessed 3 December 2014
[348] ibid
[349] ibid
[350] Bainbridge (n302) 8



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focuses attention on regularly and routinely getting information from the issuer to the market.[351]

5.3.1.2 The Securities Exchange Act of 1934

The Exchange Act of 1934 identifies and prohibits certain types of conduct in the markets, and provides the SEC with disciplinary powers over regulated entities and persons associated with them.[352] The act also empowers the SEC with broad authority over all aspects of the securities industry, and requires periodic reporting of information by companies with publicly traded securities.[353] The act governs both tender offers and proxy solicitations. The Act requires disclosure of important information by anyone seeking to acquire more than five percent of a company's securities by direct purchase or tender offer. This allows shareholders to make informed decisions on these critical corporate events. In regards to proxy solicitations, the act governs the disclosure in materials used to solicit shareholders' votes in annual or special meetings held for the election of directors, and the approval of other corporate actions.[354] The information, contained in proxy materials, must be filed with the Commission in advance of any solicitation to ensure compliance with the disclosure rules. Solicitations, whether by management or shareholder groups, must disclose all important facts concerning the issues on which shareholders are asked to vote.[355]

5.3.1.3 The Williams Act 1968

In 1968 the Williams Act amended the Exchange Act in order to impose some substantive regulation on the terms and procedures for takeover bids. These amendments to the Exchange Act included mandatory pre-bid disclosure of information regarding cash tender offers, and created a fraud remedy for communications concerning an offer. Congress passed the Williams Act due to market abuses that occurred within cash tender offers. The purpose of the act was therefore to require full and fair disclosure for the benefit of shareholders, whilst

[351] Bainbridge (n302) 9
[352] US Securities Exchange Commission, Organisation of the SEC <http://www.sec.gov/about/whatwedo.shtml#org> accessed 3 December 2014
[353] ibid
[354] ibid
[355] ibid



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at the same time providing the bidder and target management with equal opportunity to fairly present their cases.

The act subsequently requires any person who makes a cash tender offer to a company to disclose to the SEC, the source of the funds used in the offer, the purpose for which the offer is made, the plans the purchaser might have if successful, and finally any contracts or understandings concerning the target corporation. The Williams Act also makes it mandatory for anyone who acquires more than five percent of the outstanding shares of any class of a corporation subject to federal registration requirements to comply with filing and public disclosures with the SEC.[356] Copies of these disclosure statements must also be sent to each national securities exchange where the securities are traded, making the information available to shareholders and other investors.[357] The law also imposes miscellaneous substantive restrictions on the mechanics of a cash tender offer, and it imposes a broad prohibition against the use of false, misleading, or incomplete statements in connection with a tender offer. Moreover the Williams Act gives the SEC the authority to institute enforcement lawsuits and engage in litigation.

#### 5.3.1.4 The SEC

The role of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.[358] Major pieces of legislation (such as the Securities Act, the Exchange Act, and the Sarbanes-Oxley Act 2002) provide the framework for the SEC's oversight of the securities markets. These statutes are broadly drafted, establishing basic principles and objectives, and as such the SEC must ensure that the intent of Congress is carried out in specific circumstances.[359] The SEC must also engage in rulemaking as the securities markets evolve technologically and expand in size.[360]

[356] s.13(d) Securities Exchange Act 1934
[357] US Securities Exchange Commission, Organisation of the SEC <http://www.sec.gov/about/whatwedo.shtml#org> accessed 3 December 2014
[358] ibid
[359] ibid
[360] ibid



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As noted above any regulations issued by executive branch agencies, such as the SEC, are not made into federal law, rather they become federal regulations. These regulations explain how the agency intends to carry out a certain federal law, and are created through the process known as rulemaking.[361] By law, federal agencies must consult the public when creating, modifying, or deleting rules in what is called the Code of Federal Regulations, which is an annual publication that lists the official and complete text of federal agency regulations.[362] Once an agency decides that a regulation needs to be added, changed, or deleted, it typically publishes a proposed rule in the Federal Register to ask the public for comments.[363] After the agency considers public feedback and makes changes where appropriate, it then publishes a final rule in the Federal Register with a specific date for when the rule will become effective and enforceable.[364] When the agency issues a final rule for comment, it must describe and respond to the public comments it has received.[365]

The SEC consists of five presidentially-appointed Commissioners, with staggered five-year terms.[366] The agency's functional responsibilities are organised into five Divisions, which are: Corporate Finance, Trading and Markets, Investment Management, Enforcement and Economic and Risk Analysis. It is the responsibility of the Commission to interpret and enforce federal securities laws; issue new rules and amend existing rules; oversee the inspection of securities firms, brokers, investment advisers, and ratings agencies; oversee private regulatory organisations in the securities, accounting, and auditing fields; and co-ordinate US securities regulation with federal, state, and foreign authorities.[367] The Commission convenes regularly at meetings that are open to the public and the news media unless the discussion pertains to confidential subjects.[368]

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[361] Federal Regulations: The Rule Making Process, USA.gov <http://www.usa.gov/Topics/Reference-Shelf/Laws.shtml> accessed 3 December 2014
[362] ibid
[363] ibid
[364] ibid
[365] ibid
[366]US Securities Exchange Commission, Organisation of the SEC <http://www.sec.gov/about/whatwedo.shtml#org> accessed 3 December 2014; (By law, no more than three of the Commissioners may belong to the same political party, ensuring non-partisanship.)
[367] ibid
[368] ibid



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5.3.2 Federal Regulation of Single-Step Merger Process

The regulatory framework for single-step merger transactions is quite different as compared with tender offers.[369] A single-step merger is primarily regulated under the state corporation laws for mergers, and only secondarily by the federal securities laws applicable to the solicitation of the approval of the shareholders of the target company (the proxy rules).[370] A tender offer is primarily regulated under the federal securities laws relating to tender offers.[371] Both single-step mergers and tender offer transactions may however implicate the general fiduciary duty law of the state of incorporation of the target company. [372]

In a single-step transaction, modern corporation statutes give primary responsibility for negotiating a merger agreement to the target board of directors.[373] The target's board possess broad authority to determine whether to merge the firm and to select a merger partner[374] (much like a scheme of arrangement in the UK). Shareholders have no statutory power to initiate merger negotiations,[375] and the directors have the sole power to negotiate the terms on which the merger will take place and to construct a merger agreement.[376] The target directors' decision to enter into a negotiated merger transaction will however be subject to the business judgment rule. Following execution of the merger agreement, which includes such factors as price, form of consideration and other covenants including remedies for breach, the parties (bidder and target) prepare proxy materials, which are required by the SEC, to be delivered to the target company's shareholders before there is a meeting to approve the transaction.

The state laws governing shareholder voting are highly relevant to these transactions because a merger requires shareholder approval.[377] Likewise, single-step mergers also implicate the proxy rules under the Exchange Act because companies will ordinarily need to solicit proxies in order to conduct a shareholder vote, and therefore the federal proxy rules need to be

[369] Hall (n307) 1
[370] ibid
[371] Bainbridge (n302) 16
[372] Hall (n307) 1
[373] Bainbridge (n302) 57
[374] ibid
[375] Smith v Van Gorkom 488 A2d 858 (Delaware 1985)
[376] S.251 (b) Delaware General Corporation Law
[377] Bainbridge (n302) 150



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followed.[378] The proxy rules are designed to ensure that shareholders are given enough information by the target directors so that they can make an informed voting decision. The proxy materials (including the company's annual report which contains detailed financial statements and a discussion by management of the company's business) will therefore be required to be filed, in preliminary form, by the target company with the SEC before they are sent to the target shareholders, in order to assess whether they have sufficiently met the disclosure requirements.[379] The SEC then decides whether or not to review the proxy materials. If the SEC decides that it will not review the proxy materials they can then be sent directly to the target's shareholders, but this must be done within 10 days after the preliminary proxy materials are filed.

If the materials are reviewed and commented on by the SEC staff the process of obtaining and resolving any comments for amendment will most likely take four to six weeks (although longer or shorter periods are possible). The SEC's rules do however permit preliminary proxy materials to be sent to shareholders before they are cleared by the SEC staff, but this is rarely done except in hostile or contested takeovers.[380] After the proxy materials are cleared by the SEC, they are then sent to shareholders, and this thereby commences the proxy solicitation process.

#### 5.3.3 Federal Regulation of the Two-Step Merger (Tender Offer Process)

There is no fixed definition of what constitutes a tender offer, and as such various other types of transactions may also implicate the tender offer rules' including debt or equity repurchases, and certain debt restructurings. A tender offer can however be generally construed as a broad solicitation by a company, or a third party, to purchase a substantial percentage of a company's registered equity shares or units for a limited period of time.[381] The courts developed a test in Wellman v Dickinson,[382] which approved the use of eight factors suggested by the SEC to determine when a tender offer may materialise (though not

[378] Bainbridge (n302)
[379] SEC Rule 14a-3 (note the annual report can be sent to shareholders before proxies are solicited or with the other proxy solicitation materials)
[380] A Guide to US Takeovers, Clifford Chance (n313) 16
[381] US Securities Exchange Commission, Tender Offers <http://www.sec.gov/answers/tender.htm> accessed 11 November 2014
[382] 460 US 1069 (1983)



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all eight have to be present for a tender offer to be found). These factors are: whether there is an active and widespread solicitation of public shareholders; the solicitation made for a substantial percentage of the target's stock; the offer is at a premium to the prevailing market price; the terms are fixed rather than negotiable; the offer is contingent on the tender of a fixed minimum number of shares to be purchased; the offer is only open for a limited period of time; the offerees are subjected to pressure to sell their stock; and public announcements of a purchase programme for the target's securities precede or accompany rapid accumulation of large amounts of the target's securities. Other courts have also focused on whether there is a likelihood that, unless the tender offer rules are complied with, there will be a substantial risk that persons solicited will lack information needed to make a carefully considered appraisal of the bidder's proposal.[383]

Any bidder seeking to make a tender offer must prepare and file with the SEC a disclosure statement on a Schedule TO form, and comply with the relevant rules relating to tender offers.[384] Similar to the proxy materials required in a single-step merger, the Schedule TO includes disclosures relating to the terms of the tender offer, the background to the offer, a summary of the funds to be used and the sources thereof, and other relevant information. The Schedule TO must be filed with the SEC and given to the target company on the date of commencement of making the tender offer.[385] Determining when the tender offer commences is critical for several reasons: it tells the bidder when its disclosure obligation is triggered, and also many tender offer rules contain time periods that run from the commencement date.[386]

In the case of an all-cash tender offer, although the Schedule TO (Schedule 14D-1) must be filed with the SEC, it is not subject to any pre-clearance process within the SEC.[387] Accordingly, the bidder may (and customarily does) commence the tender offer and distribute the offer to purchase the target shares before receiving comments, if any, from the

[383] See Rand v Anaconda-Ericsson Inc794 F2d 843 848-49 (2d Cir 1986) *cert denied* 479 US 987 (1986) (citing Hanson Trust PLC v SCM Corp 774 F2d 47 (2d Cir 1985)).
[384] SEC Rule 14d-3
[385] SEC Rule 14d-3
[386] Bainbridge (n302) 212; see also SEC Rules 14d-2, 14d-2(a) and 14d-2(b)
[387] SEC Rule 14d-4(a)



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SEC on the Schedule TO.[388] The bidder is required however to promptly amend the Schedule TO if there is any material changes in the information provided.[389] The bidder is not in general required to distribute to target shareholders any supplement or similar document in the event of an amendment to the Schedule TO (even amendments in response to SEC comments).

Making a tender offer is subject to a variety of substantive rules with respect to the conduct of tender offers. These rules are known as the "Traffic Rules," and constitute federal regulation established by the SEC. These rules state that the tender offer must be open for acceptance for at least 20 business days from the commencement of the offer.[390] There is however no maximum limit on the duration of a tender offer, unlike the UK's strict offer timetable established by the Code; and there is no requirement under the tender offer rules for a bidder to bid for a minimum or a maximum percentage of the target common shares, in sharp contrast to the mandatory bid rule in the UK. The company that is the target of the takeover must file with the SEC its response to the tender offer on a Schedule 14D-9 form within 10 business days of the commencement of the offer. Within this form the target company must state its position on the tender offer. Specifically the target must disclose to the bidder whether they are recommending acceptance or rejection of the offer, expressing no opinion and remaining neutral toward the offer; or whether they are unable to take a position with respect to the offer.[391]

### 5.3.4 Federal Regulation on Stakebuilding

Stakebuilding potentially falls under the umbrella of a number of regulations, for example: if the bidder holds material non-public information regarding the target, purchases of the target's shares may be a violation of the SEC's Rule 10b-5; or if the takeover is to be implemented by way of a tender offer the SEC's Rule 14e-3 will prohibit certain third parties who learn of the tender offer, from acquiring the target's shares before the acquirer's plans

[388] Hall (n307) 4
[389] SEC Rule 14d-3
[390] SEC Rule 14e-1(a)
[391] SEC Rule 14e-2



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have been publicly announced; or under the "short-swing profits" rule, contained in Section 16(b) of the Exchange Act.

The other main provisions that may be triggered by stakebuilding are those under the SEC regulations, which require a person or group of persons that acquires "beneficial ownership" of more than five percent must file a Schedule 13D with the SEC (within ten days after crossing the five percent threshold).[392] In short those individuals who purchase more than five percent of shares registered on a US stock exchange must disclose their purchase. The Schedule 13D is publicly available immediately upon filing, and discloses, among other things, information about the acquirer's share position and intentions with respect to the target. The person or group is however permitted to acquire more shares after passing the five percent threshold during the 10-day period prior to the filing of the Schedule 13D. The definition of "beneficial ownership" for this purpose is broad and includes not only direct ownership but also, potentially, shares held by third parties that are the subject of options or voting commitments in favour of the acquirer, and some types of long positions established through the use of derivatives. The table below is a summary of some of the key pieces of US regulation of mergers, tender offers and the acquisition of shares under federal regulations.[393]

**Table 5.1**

| Regulation | Section/Rule | Description |
|---|---|---|
| SEA* | s.13(a) | Requires that issuers whose securities are registered with the Commission pursuant to s.12 SEA file with the Commission accurate annual reports |
| SEA | s.13(d) | Persons owning >5% of stock must file holdings on Schedule 13D report with the SEC within 10 days of purchase |

[392] The five percent must be of the outstanding shares of any class of equity securities registered under Section 12 of the Exchange Act (which would include any shares listed on a US exchange)

[393] Note that if a piece of regulation is imposed by the SEC it is a Rule, and if it is imposed by any other act it is a section of that act.



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| SEA | s.13(d)(3) | Requires that when two or more persons act as a group for the purpose of acquiring, holding or disposing of shares they will be deemed a “person” (acting in concert), such a group must file a Schedule 13D report if exceed 5% threshold |
|---|---|---|
| SEA | s.13(e) | Regulates self-tender offers |
| SEA | s.13(f) | All institutional Investors must disclose ownership regardless of number of stock owned |
| SEA | s.14(a) | Rules on proxy solicitation |
| SEA | s.14(d) | Regulates tender offers generally (rules on disclosure and procedure) |
| SEA<br><br>SEC | s.14(e)<br><br>12b-20 | Regulates unlawful tender offer practices (prohibits fraud)<br>Requires that reports required under s.13(a) contain any additional information necessary to ensure that the required statements in the reports are not, under the circumstances, materially misleading |
| SEC | 13a-11 | Every registrant subject to s.13(a) shall file a current report on Form 8-K within the period specified in that form |
| SEC | 14a-3, 14a-8, 14a-12 | Rules on exempt communications from definition of solicitation regarding proxy rules |
| SEC | 14d-1 | Regulates the scope and definitions of s.14(d) and s.14(e), including required mandatory disclosures under these provisions |
| SEC | 14d-2 | Governs the commencement of an offer |
| SEC | 14d-5 | Dissemination of certain tender offers by the use of stockholder lists and security position listings. |
| SEC | 14d-6 | Disclosure requirements with respect to tender offers |



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| SEC | 14d-7 | Withdrawal rights: any person who has deposited securities pursuant to a tender offer has the right to withdraw any such securities during the period such offer request or invitation remains open |
|---|---|---|
| SEC | 14d-9 | Regulates target directors' disclosure statement, on the 14D-9 form, to target shareholders |
| SEC | 14d-9(f) | Target board must file 14D-9 Form with SEC disclosing reasons for boards position on an offer |
| SEC | 14d-10 | If the bidder increases offer, target shareholders who have already accepted the previous offer are also entitled to the increased offer |
| SEC | 14e-1 | Bidder must keep offer open for at least 20 business days |
| SEC | 14e-2 | Target Directors must disclosure their position on an offer to shareholders within 10 business days of commencement of the offer |

*Securities Exchange Act

### 5.4 US Regulatory Regime: State Laws

State laws generally apply to the particular state that enacted the law. State legislatures create and pass bills, and the governor of the state then signs the bills into law. State courts may review these laws and remove them if they feel they do not agree with the state's constitution. Virtually all US corporations are formed (or incorporated) under the laws of a single state by filing articles of incorporation with the appropriate state official.[394] The state in which the articles of incorporation are filed is known as the state of incorporation. Selecting a state of incorporation has important consequences because of the internal affairs doctrine, which is a conflicts of law rule, holding that corporate governance matters are controlled by the law of

[394] Bainbridge (n302) 5



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the state of incorporation.[395] Almost all US jurisdictions follow the internal affairs doctrine, even if the corporation in question has no ties to the state of incorporation other than the mere fact of incorporation.[396]

In the context of takeovers, state corporate laws govern the ability of a target company's board of directors to reject or resist unsolicited takeover proposals, as well as the board's responsibilities when negotiating the terms of a takeover or merger, and choosing among competing proposals.[397] State corporate laws, which govern a company's ability to resist unwanted takeovers, tend to be anti-takeover. Delaware laws, which are the focus of the discussion in regards to US state regulation, are in favour of directors being able to defend against undesirable takeovers however they are by no means the most stringent anti-takeover laws. This section will discuss these anti-takeover statutes in more detail, focusing not just on Delaware statutes but more generally the types of anti-takeover laws that may be found across the US. But first, the section will address the standard of conduct required by the target company's board of directors which are imposed through the imposition of fiduciary duties.[398]

### 5.4.1 Fiduciary Duties

The fiduciary duties of directors in the US were first established by common law judges, operating without any guidance from the formal written law.[399] This is identical to the development of such duties in the UK. The UK directors' duties are now however codified within the 2006 Companies Act; by contrast the company laws of the US still contain no clarification of the core fiduciary duties.[400] This has meant that directors' fiduciary duties continue to evolve without any formal written law.[401] This has created some confusion in the courts as to what duties directors owe and what those duties encompass. It is however argued that there are three fundamental fiduciary duties which are imposed upon directors,

[395] Bainbridge (n302) 5
[396] ibid
[397] A Guide to US Takeovers, Clifford Chance (n313) 2
[398] ibid 27
[399] Bernard S Black, 'The Principal Fiduciary Duties of Boards of Directors' [2001] Third Asian Roundtable on Corporate Governance 1. 1
[400] ibid
[401] ibid



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specifically the duties of loyalty, care and disclosure. A controversial issue however surrounds the disagreement by court judges as to whether good faith, a standard integral to the evaluation of directors' behaviour, is a separate duty owed by directors. Furthermore, these duties are subject to the business judgement rule, which shields corporate managers from judicial scrutiny of their decisions. To complicate matters further, there may also be at least two additional core duties that directors have today when takeovers are specifically concerned. These are known as enhanced duties and will be discussed in section 5.4.6.[402] The main duties of loyalty, care and disclosure will be discussed in detail in this section, together with a discussion of the issue of good faith, and an explanation of the business judgement rule. Firstly however a brief overview of fiduciary duties of Delaware state law will be given.

### 5.4.2 State Law: The General Corporation Law

In order to ensure that directors act in the best interests of the company, state law which encompasses both statutory and common law, imposes fiduciary duties upon directors. This is because the discretion afforded to directors by state law is so wide, it is vitally important that directors do not exercise this discretion for improper purposes.[403] The General Corporation Law of the State of Delaware ("DGCL") embraces a strong "republican model" of representation, investing corporate directors with broad managerial powers and duties during their terms in office and giving directors extensive authority to undertake lawful actions in the pursuit of profit.[404]

In Delaware the duties of loyalty and care are governed under the Delaware Limited Liability Company Act (LLC Act). Whilst the LLC Act does not directly impose fiduciary duties of loyalty and care on a manager, it does allow parties to contract for these fiduciary duties in an LLC operating agreement. One of the LLC Act's main policy objectives under section 18-1104 is to 'give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.'[405] Accordingly, Delaware courts, when deciding if a duty has been breached, will turn first to the contracted for provisions in

[402] See for example Black (n399)
[403] Leo Strine, Lawrence Hamermesh, R. Franklin Balotti, Jeffrey Gorris 'Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law' (2009) 98 Georgetown Law Journal 630, 634
[404] ibid
[405] Delaware Code § 18-1101(b)



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the governing LLC operating agreement, in order to determine the parameters of a manager's duties.[406] **S**ince August 2013, however, the Delaware General Assembly has amended Section 18-1104 of the LLC Act, to provide that, unless the limited liability company agreement says otherwise, managers and controlling members of a limited liability company will owe fiduciary duties of care and loyalty to the limited liability company and its other members.

The amendment was prompted by a Delaware Supreme Court decision in Gatz Properties LLC v Auriga Capital Corp[407] in which the **c**ourt declined to express any view regarding whether default fiduciary duties applied as a matter of statutory construction and suggested that the General Assembly resolve any statutory ambiguity on this issue.[408] The General Assembly therefore explained that the amendment to the act was to do just that, and to confirm that in some circumstances fiduciary duties not explicitly provided for in the limited liability company agreements do apply. By way of example, a manager of a manager-managed limited liability company would ordinarily have fiduciary duties even in the absence of a provision in the limited liability company agreement establishing such duties.[409] The General Assembly went on to explain that Section 18-1101(c) continues to provide that such duties may be expanded, restricted or eliminated by the limited liability company agreement but this is subject to the implied covenant of good faith and fair dealing.[410] Directors may therefore exclude themselves from these duties if explicitly stated in the company's operating agreement.

### 5.4.3 Duty of Loyalty, Care and Disclosure

The duty of loyalty, arguably the most important fiduciary duty, requires directors to act in the interests of the company, and not in their own interests. The easiest way to comply with this duty is not to engage in transactions that involve a conflict of interest, or "self-dealing"

[406] John J Hanley, Austin D Keyes, 'Fiduciary Duties for Managers of Delaware Limited Liability Companies' (June 2013) <http://www.clm.com/publication.cfm?ID=444#_ftnref3> accessed 1 August 2015
[407] CA 4390-CS (Delaware Chancery Jan 27 2012)
[408] Gatz Props LLC 40 A3d 839 (Delaware Chancery 2012)
[409] House of Representatives, 147th General Assembly, House Bill No. 126, An act to Amend Chapter 18, Title 6 of the Delaware Code relating to the creation, regulation, operation and dissolution of domestic limited liability companies and the registration and regulation of foreign limited liability companies. Synopsis of section 8
[410] ibid



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transactions. An alleged conflict of interest will provide a basis to attack a board's decision when a self-interested director meets the following criteria: firstly that they constitute a majority of the board of directors; secondly that they control and dominate the board of directors as a whole; and thirdly they fail to disclose their interests in the transaction in a situation where a reasonable member of the board of directors would have regarded the existence of the material interest as a significant fact in the evaluation of the proposed transaction.[411] Some academics however believe that every fiduciary act implicates the duty of loyalty, because every act must be taken for a proper corporate purpose.[412]

The duty of care requires directors to act on an informed and deliberate basis, with the degree of care that an ordinarily prudent person would use under similar circumstances.[413] In essence, this duty requires directors to make well-informed business decisions. To satisfy the duty of care in connection with making decisions on behalf of the corporation, a director must inform himself of all material, relevant information that is reasonably available to him.[414] This is typically accomplished by, among other things, attending and participating in meetings of the board of directors; asking questions; probing assumptions and studying materials necessary to vote or act in an informed manner; taking time to evaluate the action under consideration; considering the advice of experts; and making deliberate decisions after thorough and candid discussions.[415] There does not need to be a conflict of interest in order for the duty of care to arise. The duty however requires that the directors show up, pay attention and to try to make good decisions.[416] US courts simply do not hold directors liable for business decisions, made without a conflict of interest, unless those decisions are completely irrational. This doctrine of non-interference is known in the US as the business judgment rule.

[411] Cornell University Law School, Legal Dictionary <http://www.law.cornell.edu/wex/duty_of_loyalty> accessed 11 December 2014
[412] Strine et al (n403) 8
[413] Model Business Corporation Act § 8.30
[414] See Francis v United Jersey Bank 87 NJ 15 432 A2d 814 (1981); Bates v Dresser 251 US 524 (1920)
[415] A Guide to US Takeovers, Clifford Chance (n313) 27
[416] Black (n399) 6



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The third duty, the duty of disclosure, or the "duty of candor," requires directors to fully and fairly disclose all material information within a board's control[417] and to provide a balanced, truthful account of all matters disclosed in communications with shareholders.[418] Information is treated as material if there is a substantial likelihood that a reasonable shareholder would consider information important in deciding how to vote.[419]

### 5.4.4 Duty of Good Faith

The duties as outlined above are the main fiduciary duties applied by the courts to corporate actions by directors. There has however been confusion in the US courts as to whether the concept of good faith, amounts to a separate and distinct fiduciary duty from that of loyalty and care. This confusion began in Cede & Co v Technicolour when it was stated that there was a triad of fiduciary duties, specifically, loyalty, care and good faith.[420] The court in a leading case on this matter gave a detailed definition of good faith (though whether good faith amounted to a separate and distinct duty was not commented on).[421] It was established that good faith amounts to all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders.[422] It was stated by the court that '[T]he concept of intentional dereliction of duty, a conscious disregard for one's responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith.'[423] In a more detailed elaboration, the court said, a failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.[424]

[417] Gantler v Stephens 965 A2d 695 (2009)
[418] A Guide to US Takeovers, Clifford Chance (n313) 27
[419] Rosenblatt v Getty Oil Co 493 A2d 929 (1985)
[420] 634 A.2d 345 (1993)
[421] In re Walt Disney Derivative Litigation 907 A2d 693 (Delaware Chancery 2005)
[422] ibid
[423] ibid per Chancellor Chandler [755]
[424] In re Walt Disney Derivative Litigation 907 A 2d 693 (2005)



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In Stone v Ritter,[425] the courts conclusively confirmed that good faith is not an independent fiduciary duty that stands on the same footing as care and loyalty,[426] but that good faith was to be subsumed within the duty of loyalty. This reasoning was developed from the notion that a director cannot act loyally towards the corporation unless they acted in good faith, and that those actions were in the best interests of the company.[427] Traditionally however, the duty of loyalty focused on cases in which the defendant fiduciary received an improper financial benefit and the traditional remedy was to therefore strip the benefit away from the director. Bainbridge has therefore put forward the argument that the effect of Stone extends the domain of loyalty to one in which the director received a financial benefit and makes it even more doctrinally difficult to require causation, while simultaneously creating a conceptually difficult task of crafting appropriate remedies.[428]Alternatively, Hill and McDonnell[429] state that although it is true that recessionary damages are the standard form of remedy in standard loyalty cases, the Delaware Supreme Court had already held that in loyalty cases the court may 'fashion any form of equitable and monetary relief as may be appropriate.'[430] Thus, recessionary damages are not the exclusive remedy available, and compensatory damages may also be used, as appropriate.[431] As such, if there is no ill-gotten gain in any particular case, that simply means that one of several possible damage measures is not available in that case, but other measures may still be used.[432]

Strine et al noted that Stone v. Ritter was an important, but ultimately, mundane and unsurprising decision.[433] The concept of good faith has long been a vital one in Delaware's corporate law, but not as a fiduciary duty separate from the fundamental duty of loyalty. They argued that the term good faith had long been used as the key element in defining the state of mind that must motivate a loyal fiduciary.[434] The Delaware Supreme Court, both in Technicolor itself and in other decisions contemporaneous with it, understood and frequently

[425] Delaware Supreme Court 911 A2d 362 en banc (2006)
[426] 911 A.2d 362, 370 (Delaware 2006)
[427] ibid
[428] Bainbridge (n302) 304
[429] CA Hill, BH McDonnell, 'Stone V. Ritter and the Expanding Duty of Loyalty' (2007) 76 Fordham Law Review 1769, 1788
[430] Weinberger v UOP Inc 457 A2d 701 710 (Delaware 1983)
[431] Hill & McDonnell (n429) 1788
[432] ibid
[433] Strine et al (n403) 3
[434] ibid



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applied the concept of good faith in just this traditional way, as the state of mind required of a loyal director.[435]

*'[US law] has been clear that the duty of loyalty is implicated by all director actions, because all such actions must be undertaken in good faith to advance the corporation's best interests and because directors owe an affirmative obligation to put in a good faith effort to responsibly carry out their duties. To shrink the hallmark duty of loyalty to make way for a separate duty that simply embraces the traditional definition of a loyal state of mind adds confusion not clarity. In so stating, we acknowledge that the duty of loyalty remains, as it always has, most difficult to apply to circumstances when directors act without an apparent selfish interest for injuring the corporation. We also acknowledge that it is in that context that the concept of good faith has its greatest utility.'*[436]

### 5.4.5 The Business Judgement Rule

The business judgment rule shields corporate managers from judicial scrutiny of their decisions, however it will not apply if it can be demonstrated that there is a conflict of interest. If there is a conflict of interest the standard required by the duty of loyalty will be applied. If there is no conflict of interest, the business judgment rule comes into play.[437] According to the canonical formulation of the business judgment rule, it is 'a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'[438] Bainbridge however notes that rather than "presumes," it is assumed that the courts should not review directors' decisions unless there has been fraud, illegality or self-dealing.[439]

Consequently in order for the business judgement rule to protect directors the court must find: (i) an exercise of judgement; (ii) disinterested and independent decisions makers (i.e. no self-dealing); (iii) an absence of fraud or illegality, rationality (which is interpreted as a decision

[435] Strine et al (n403) 4
[436] ibid 5
[437] See Black (n399)
[438] Aronson v Lewis 473 A2d 805 812 (Delaware 1984)
[439] Bainbridge (n302) 61



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which is not egregious, irrational or so beyond reason); (iv) an informed decision (which demonstrates process due care). The exercise of process of due care is separate from the duty of care, and is an essential precondition for application of the business judgement rule. The leading authority on the business judgement rule, Smith v Van Gorkom,[440] affirmed that directors must inform themselves of all material information reasonably available to them. In the context of mergers and takeover offers, directors must consult with senior management when setting the price and they must focus on the primary objective (i.e. to secure the transaction offering the best value reasonably available to all shareholders). They must also negotiate, and not be pressured by a short-time frame (the courts have noted that those boards that have failed to exercise due care are frequently boards that have been rushed).[441] In order for the decision to be an informed decision, directors must have informed themselves of all information reasonably available to themselves, they must not just be going through the motions, and the decision making process must be adequate.

### 5.4.6 Enhanced Fiduciary Duties

In addition to the fiduciary duties noted above (loyalty, care and disclosure) Delaware common law also applies a special enhanced standard of review in two specific circumstances relating to mergers and acquisitions. These specific circumstances are firstly, when a company is resisting an unwanted takeover, and secondly when a company is willing to be taken over but employs tactics in order to gain a better financial outcome for its shareholders. Bainbridge notes that because of the conflict of interest that can exist between those of the company and those of the directors in these situations, judges can justify an intervention of the commercial decisions of directors, and as such scrutinise decisions made by the board of directors of a target company much more closely.[442] The permissibility of target directors' behaviour in these circumstances is decided by applying these specifically developed enhanced duties, which are referred to by the names of the cases that gave rise to the doctrines, Unocal[443] and Revlon.[444] Unocal duties apply in circumstances where a board takes corporate steps that may deter one or more potential buyers, which are frequently called

[440] Smith v Van Gorkom (n375)
[441] McMullin v Beran 765 A2d 910 (Delaware Supreme Court 2000)
[442] Bainbridge (n302) 255
[443] Unocal Corp v Mesa Petroleum Co 493 A2d 946 (Delaware 1985)
[444] Revlon Inc v MacAndrews & Forbes Holdings 506 A2d 173 (Delaware Supreme Court 1986)



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defensive measures.[445] Revlon duties primarily, but not exclusively, arise when a company engages in a transaction that results in a change of control.[446] These cases and the standards of review which were developed by the Delaware courts will now be discussed.

5.4.6.1 The Unocal and Revlon Standards

It has been difficult for the US courts to unite the principles of traditional fiduciary duties imposed upon directors with the unique circumstances which takeovers and mergers present. For instance, takeover defences such as a question of loyalty would include a question of fairness. The director would therefore be required to establish that the transaction was fair to the corporation.[447] Bainbridge notes that this burden is exceedingly difficult to prove and would result in the judicial scrutiny and invalidation of takeover defences.[448] As such defences of takeovers would never be allowed.[449] In terms of the duty of care, Bainbridge states, that all takeovers would survive judicial review, because before the director is called to account for their actions, the court would have to rebut the business judgement rule by demonstrating fraud, illegality or self-dealing.[450] Delaware Supreme Court therefore tried to "steer a middle ground" between these two duties by creating the enhanced business rule which is applied using the Unocal and Revlon doctrines.[451] These doctrines play an extremely important role in the development of the regulation of takeovers in the US, and in particular the behaviour of the target board in refusing a tender offer. In order to describe the doctrines however, a brief historical explanation of the cases themselves and some of the related case law that led to the development and stability of these doctrines must be outlined.

The courts initially in Cheff v Mathes[452] developed a primary purpose test (similar to the proper purpose doctrine in the UK), in which directors were not given immediate sanctuary under the business judgement rule until it could be shown that: there was a reasonable ground

[445] Erik J Olson, 'Shareholder Class Action Litigation Arising from Mergers and Acquisitions' (January 2012) <http://www.acc.com/legalresources/quickcounsel/scalafma.cfm> accessed 11 November 14
[446] ibid
[447] Bainbridge (n302) 256
[448] ibid
[449] ibid
[450] ibid
[451] ibid
[452] 199 A2d 588 (Delaware Supreme Court 1964)



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to believe that a danger to corporate policy or ineffectiveness existed; and that the director did not act for the primary purpose of preserving themselves. This test however became easy to overcome because directors could easily justify defensive action on policy grounds. The court therefore developed a new standard, in which directors were to be judged during a takeover or merger, in the leading case of Unocal.[453] This was to be called the enhanced business judgement rule. This enhanced standard would now need to be satisfied before the business judgement rule could be applied. This was due to the board's potential conflict of interest in corporate takeover situations, and therefore judicial review needed to be more intrusive. The court stated 'because of the omnipresent spectre that a board may be acting primarily in its own interests rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before protections of the business judgement rule may be conferred.'[454]

In Unocal a discriminatory self-tender offer was made in which the target firm offered a huge premium for its shares but excluded the bidder from the offer, subject to the proviso that the self-tender would become effective only if the bidder acquired a specified amount of stock. It is evident that the target's self-tender was intended never to take effect, since rational shareholders would never tender to the bidder when they could obtain more from the target. Despite the target's seemingly sham offer and the management's discrimination between shareholders, the Delaware Supreme Court upheld the target's strategy as 'reasonable in relation to the threat…posed' by the bidder.[455]

The Delaware Supreme Court in upholding Unocal's exclusionary self-tender, 'made it plain that it was not prepared to defer blindly to any and all takeover defences.'[456] In the case of such transactions, the court said, that the business judgment rule would be applied if two pre-requisites were established. First, the directors must show that they reasonably determined that the threatened takeover was a danger to corporate policy or effectiveness.[457] The

[453] Unocal Corp (n443)
[454] ibid
[455] ibid at 958
[456] C William Phillips, Preethi Krishnamurthy 'The Landscape of U.S. Hostile Takeover Litigation' *Covington & Burling* <https://www.cov.com/~/media/files/corporate/publications/2001/12/oid6533.pdf> accessed 15 January 2014 16
[457] Unocal Corp (n443)



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directors can satisfy that burden by showing good faith and reasonable investigation.[458] Good faith is understood as acting in response to a perceived threat and not for the purpose of entrenching themselves. Reasonable investigation is met when a board has been adequately informed.[459] Second, the defensive transaction must bear a reasonable relationship to the perceived threat. The court would not tolerate resistance to takeovers by any draconian means available.[460] This test can therefore capture cases in which conflicted interest drove the board's decision making process.[461] If the directors met the grounds under the two step burden the business judgement rule applied but if directors failed to do so the duty of loyalty applied.[462] This has become known as the Unocal standard, and is how directors' actions are judged during a takeover bid. The courts then went on to develop a further standard in Revlon for situations where it was felt Unocal may no longer be an effective standard to be held to.

The case of Revlon involved competing bids, and in this situation the courts decided that the directors no longer faced threats to corporate policy and effectiveness. That the director's role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for shareholders at the sale of the company. The Delaware Supreme Court therefore crafted a "duty to auction" that seemed to prune back the broadest implications of the earlier Unocal case.[463] The court stated that once the target firm was clearly going to be sold, the duty of the target's board 'changed from the preservation of **...** [the target firm] as a corporate entity to the maximisation of the company's value at a sale for the stockholders' benefit.'[464] This significantly altered the board's responsibilities under Unocal.

For some time Revlon appeared in tension with Unocal.[465] The courts were in confusion as to when each would apply, and therefore how it has been interpreted by a small number of cases has been highly controversial. In Paramount Communications v Time Inc.,[466] the Delaware

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[458] Unocal Corp (n443)
[459] See Moran v Household International Inc 500 A2d 1346 (Delaware 1985)
[460] Unocal Corp (n443)
[461] Bainbridge (n302) 257
[462] Shamrock Holdings Inc v Polaroid Corp 559 A2d 257 (Delaware Chancery 1989)
[463] Geoffrey Miller, 'Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England' (1998) 51 Columbia Business Law Review 51. 56
[464] Revlon (n444) [182]
[465] Miller (n463) 57
[466] 571 A2d 1140 (Delaware 1989)



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Supreme Court held that the Revlon duty to auction was not triggered, even though there was a change in control and competing bidders. In this case Time's management had rejected an all cash offer from Paramount which was financially superior to the merger proposal they previously had agreed to with Warner Brothers. They found that Time's response to Paramount's bid was reasonable in relation to the threat posed, stating that '[d]irectors are not obligated to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.'[467] The Time case seemed to suggest that Revlon's duty to auction could be avoided rather easily with proper legal and business planning, and that the Delaware courts would not overturn management's purported reasons for opposing a hostile bid so long as the current board could point to some type of long term business plan which was inconsistent with a hostile acquisition.[468] The court in Paramount stated that Revlon did not apply to this case because it was a merger agreement and was therefore not a change of control. This case had the result of weakening Unocal by expanding the list of cognisable threats and weakened the proportionality test.[469] The Time interpretation of Revlon has now however been "consigned to the dust bin of history,"[470] as it has been limited to its own unique facts by the later decision of Paramount Communications Inc. v QVC Network.[471]

Within this case Paramount's board approved a merger with Viacom and adopted defensive measures to block an unsolicited, more valuable tender offer from QVC Network. Distinguishing the Time case on the somewhat tenuous ground that no "sale of control" was involved in the earlier matter, the Delaware Supreme Court found that the Revlon duties applied to the actions of Paramount's board and that the board had breached its duty by rejecting the QVC bid.[472] The court confirmed that Revlon will therefore apply in situations where: (i) the corporation initiates an active bidding process seeking to sell itself or a clear break-up of the company; (ii) in response to a bidders offer, a target abandons its long-term strategy and seeks an alternative transaction including the break-up of the company; (iii) when approval of a transaction results in a sale or change of control. Outside of these scenarios Unocal remains as the defining standards. The courts have confirmed that Revlon is

[467] Paramount Communications v Time Inc. (n446) [1154]
[468] Miller (n463) 57
[469] Bainbridge (n302) 275
[470] Bainbridge (n302) 276
[471] 637 A2d 34 (Delaware 1994)
[472] Miller (n463) 57



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a variant of Unocal and not a separate doctrine. If the board of a target company is pursuing a sale of the company, it may seek to satisfy its Revlon obligation to maximise value for shareholders by running an auction or market check process. Delaware courts have said, however, that while an auction or market check process may be desirable, it is not invariably required.[473]

The courts also verified that control transactions justified enhanced judicial scrutiny, and that it will take form as a reasonableness inquiry to be applied on a case by case basis. The key features of the enhanced scrutiny are: (i) judicial determination regarding the adequacy of the decision making process of the directors including the information upon which the directors based their decision; (ii) reasonableness of directors' actions in light of the existing circumstances. The burden of proof is on the directors in respect of both issues (directors do not need to prove it was the "right" decision). As long as the board's conduct falls within the bounds of reasonableness the Delaware courts will not second guess the board's decision. Therefore 'motive is what counts; a reasonable decision is unlikely to be motivated by conflicted interests.'[474]

The leading cases in Delaware demonstrate the sometimes inconsistent nature of the courts approach to the regulation of incumbent management's fiduciary duties in response to an unsolicited takeover bid.[475] In order to defend against a takeover, however, managers would generally be required to show that the hostile offer represented a threat to the corporation and the defence was reasonably proportionate to the threat.[476] If it became clear that the company would be sold or broken up, managers' use of defences would be limited still further. Consequently defences would be permissible only to the extent target managers used them to try to get the highest price for their shareholders.[477] The discretion vested in target managers is however not absolute. Managers are sometimes required to remove takeover defences, when the defences tilt the playing field toward one bidder in the heat of an actively contested takeover battle. The board must, in using defensive tactics leave some mechanism by which

[473] A Guide to US Takeovers, Clifford Chance (n313) 29
[474] Bainbridge (n302) 276
[475] Miller (n463) 58
[476] Unocal Corp (n443) [954]
[477] Revlon (n444) [182]



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the bidder can eventually present an offer to the shareholder.[478] The court strongly emphasised that the directors have an authority to erect defences with teeth.[479] The court has however held that no-hand pills are invalid because these defences affect the ability of new directors to carry out their best judgement.[480] Under Unocal, a director can discriminate against bidders, but once Revlon has been triggered the target board loses most of its power to affect the outcome of a contest. They must secure/endeavour to secure the highest value reasonably attainable and take an active role in the sale process. Liability will only arise out of bad faith or self-interest. Under Revlon favouritism has been the trigger for asserting that a board is acting from improper motives.

Revlon should be understood as a special case of the Unocal heightened scrutiny standard of review.[481] The target board of directors' sole Revlon duty is to obtain the best deal for their shareholders. In doing so any favouritism of one bidder over another must be motivated by a concern for immediate shareholder value and not by any improper motives.[482] Target boards under Unocal, do however have extensive discretion, particularly if they wish to "just say no" to any bid to acquire the company.[483] "Just say no" is a strategy used by corporations to discourage hostile takeovers in which board members quite literally reject a takeover bid outright by refusing the offer, a concept which has caused much controversy because it can be used to take away decision making power from shareholders.

### 5.4.7 "Just Say No": Managerial Discretion

Though the Delaware courts have not endorsed the "just say no" strategy, their recent decision in Air Products & Chemicals Inc. v Airgas Inc.[484] demonstrates that a board may refuse a bid outright if the target company has a long-term strategy that it is pursuing, or if the takeover bid simply undervalues the company (as was decided in the Time case).

[478] Moran (n459)
[479] ibid
[480] Quickturn designs Systems Inc v Mentor Graphics Corp 721 A2d 1281 (Delaware Supreme 1998)
[481] Bainbridge (n302) 315
[482] ibid 315
[483] Armour, Skeel (n34) 1734: see also Leo E Strine Jr, 'The Professorial Bear Hug: The ESB Proposal as a Conscious Effort to Make the Delaware Courts Confront the Basic 'Just Say No' Question' (2002) 55 Stanford Law Review 863; David Bank, 'How a Judge's Ruling May Curb 'Poison Pill' as Takeover Defence' *Wall Street Journal* (13 December 2004) 1
[484] 2011 WL 806417 (Delaware Chancery 2011)



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In this case, Air Products sought to acquire Airgas through discussions with management, but the Airgas board rejected the proposal. The Airgas board, relying principally on its belief in management's long-term business plan, repeatedly rejected a number of offers made by Air Products as inadequate despite several increases in the offer price during the course of the contest. Ultimately, Air Products asked the court to order Airgas to redeem its poison pill so that the company's shareholders could decide whether to accept the Air Products offer. Viewing the case fundamentally as a decision on whether a board's fiduciary duties, in the context of a hostile takeover, require it to abandon its long-term plans and instead permit stockholders to decide the target's fate,[485] the court concluded that 'as Delaware law currently stands, the answer must be that the power to defeat an inadequate hostile tender offer ultimately lies with the board of directors.'[486] Using the Unocal analysis, the court found that the Airgas board acted in good faith and had demonstrated that it had conducted a reasonable investigation.[487] The credibility of Airgas' business plan, which had been carefully reviewed by the board and which, as the court noted, was not "tweaked" or "fudged" on an ad hoc basis during the takeover contest, was a major factor in the court's deference to the Airgas board's business judgment not to sell the company. The court also noted that while many of Airgas' shareholders clearly wanted to tender their shares for short-term gain, under Delaware law the board has sole authority, when acting deliberately and in an informed manner, to decide the time frame for realising corporate goals and strategies.

The court confirmed that a board may "just say no" to a tender offer, but only in certain circumstances. A board of directors for example, found to be acting in good faith, after reasonable investigation and reliance on the advice of outside advisors, can convince the court that a hostile tender offer posed a legitimate threat to the corporate enterprise, and that they addressed that perceived threat by blocking the tender offer and forcing the bidder to elect a board majority that supports its bid.[488] The Delaware Chancery Court in Airgas also confirmed that directors of a target company can refuse to redeem the company's poison pill in the face of an inadequate hostile offer to its shareholders, even if a majority of the shareholders would likely tender into the offer, and even if the board has had adequate time

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[485] Delaware Chancery Court Reaffirms Poison Pill and "Just Say No" Defense in Airgas Takeover Battle (Simpson and Thatcher 2011) <http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1127.pdf?sfvrsn=2> accessed 11 November 2014; see also Strine (2002) (n)
[486] Airgas Inc (n484) Per Chancellor Chandler [4]
[487] ibid
[488] ibid



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to explore alternatives and fully explain its views to the shareholders. The court concluded that responding to the threat by maintaining the poison pill was within a range of reasonable responses, noting that the use of defensive measures to prevent a change of control from occurring at an inadequate price is a 'course of action [that] has been clearly recognized under Delaware law.'[489] A board cannot therefore just say no. Instead the board must conduct a reasonable investigation, it must hire independent outside experts, and it must then determine that at least the threat of inadequate value is present, only then can a board just say no.[490] This however may be a trivial standard, as a target will always be able to find credible experts who could put a higher value on the company than the hostile bidder offers.[491] The Airgas decision therefore stands as the most important pill reaffirmation case in a number of years and should provide added comfort to a target board that a decision to refuse an inadequate bid is a valid strategy.[492]

In summary, the Airgas case confirmed that: inadequate price is a valid threat to corporate policy and effectiveness; the selection of time frame for achievement of corporate goals may not be delegated to the shareholders; directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is no basis to sustain the corporate strategy; in line with the previous decisions if a board, in good faith, on a reasonable basis, believes a bid is inadequate it may block that bid using a poison pill irrespective of shareholders desire to accept; and finally, that defensive measures are not preclusive as long as obtaining control at some point in the future is realistically attainable.

### 5.4.8 Anti-takeover Statutes

Nearly every state has enacted anti-takeover legislation that is designed to slow down unwanted takeovers.[493] Initially, however these statutes were so anti-takeover they were struck down as unconstitutional in Edgar v MITE Corp[494]. State lawmakers subsequently

[489] Airgas Inc (n484) per Chancellor Chandler [497]
[490] Bainbridge (n302) 315
[491] ibid
[492] Simpson, Thatcher (n485)
[493] Armour, Skeel (n34) 1735
[494] 457 US 624 (1982)



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revised their anti-takeover statutes, and are now known as the second generation statutes, which were upheld as constitutional in CTS Corp v Dynamics Corp of America.[495]

These second generation statutes are for the most part, tailored to avoid direct regulation of tender offers; instead they address issues purporting to fall within the sphere of corporate governance concerns, which are traditionally subject to state law.[496] The statutes come in a variety of forms, but all share the common feature of serving to consolidate the ability to respond to tender offers. Some state statutes provide discretion to directors to impede and delay unwanted tender offers, thereby significantly raising their cost.[497] Other statutes go so far as to enable managers and directors to revoke the fiduciary duties of care and loyalty traditionally owed to shareholders, by enabling or requiring such managers and directors to consider the effects of a takeover on customers, employees, suppliers, creditors and even the local economy when deciding whether or not to resist a takeover.[498]

Although anti-takeover provisions come in various forms they are generally categorised into four different varieties: control share acquisition statutes, fair price statues, business combination statutes and cash-out statutes.[499] The first of these, control-share acquisition statutes, rely on the state's traditional power to define corporate voting rights as a justification for regulating the bidders right to vote shares acquired in a control transaction.[500] A control share acquisition is typically defined as the acquisition of a sufficient number of target company shares to give the acquirer control over more than a specified percentage of the voting power of the target.[501] These provisions operate by requiring shareholder approval before acquirers of large blocks of stock can vote on their shares.[502] The typical thresholds are 20, 33 and 50 percent, because these are the trigger levels of share ownership which would bring the bidder within a range of voting power. The purpose of control share statutes

[495] (n335)
[496] Bainbridge (n302) 329
[497] Jonathan R Macey, 'State Anti-Takeover Statutes: Good Politics, Bad Economics' (1988) Faculty Scholarship Paper 1739 469
[498] ibid 469
[499] ibid 468
[500] Bainbridge (n302) 330
[501] ibid
[502] See Indiana Code Ann S 23-1-42 and Ohio Revised Code Ann S 1701.831



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is to provide shareholders with an opportunity to vote on a proposed acquisition of large share blocks that may result in, or lead to, a change in control of the target.[503]

Fair price statutes are modelled on the approach taken in company charters that include fair price provisions.[504] These provisions require that a company obtain a two-thirds or higher supermajority vote of its shareholders before entering into a business combination with a person owning a certain, threshold percentage of the company's shares.[505] The only way to avoid the necessity of a shareholder vote is for the business combination to obtain the approval of the board of directors or for the bidder to pay a fair price for the shares acquired in the combination.[506] A fair price is defined as 'the higher of any price the interested party [, the bidder,] paid to obtain its shares or the market price at the time of the combination.'[507]

The third variety of anti-takeover provisions is the business combination statues, which are sometimes known as "freeze-out" statutes. These provisions are an 'extension of the fair price statute concept, providing substantially greater teeth.'[508] 'The typical statute prohibits a target from engaging in any business combination with an interested shareholder[509] of the target company for a set period of time, often for a period of five years, following the date on which the interested shareholder is still prohibited (unless the business combination is approved by a specified vote of the outstanding shares not beneficially owned by the interested shareholders, or the business combination meets the specified fair price).[510] The fourth variety of anti-takeover laws is the cash-out statutes, which 'require a bidder of more than a threshold percentage of a target's shares to offer to purchase the remaining shares of all of the other shareholders at a price which reflects the highest premium paid by the bidder in accumulating target stock.'[511]

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[503] Bainbridge (n302) 330 (note that the shares already owned by the bidder or officers of the target and directors who are also employees of the target, may not be counted in the vote on the resolution.)
[504] ibid
[505] Macey (n497) fn 4
[506] Roberta Romano, 'The Political Economy of Takeover Statutes' (1987) 73 Virginia Law Review 11, 116
[507] ibid
[508] Bainbridge (n302) 331
[509] ibid (Bainbridge notes that the term "interested shareholder" is typically defined by statue as a shareholder owning more than some specified percentage, often 10 percent of the outstanding shares of the target)
[510] ibid; see also New York Business Corporate Law s.912(c); Delaware General Corporation Law s.203
[511] Bainbridge (n302) 331



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Some states have also passed laws granting firms the right to adopt poison pill takeover defences. These laws have an important impact upon a target board of directors' ability to defend against an unwanted bid because the right to use poison pill defences is presumably more secure when explicitly authorised by statute, and is thus less likely to be seen as an unreasonable measure by the courts.[512] Other states have also passed laws that can be referred to as registration and disclosure laws. These laws require bidding firms to file certain documents with the state to register their ownership stake in the target firm and to disclose their funding and intentions. These requirements are minor extensions of the disclosure provisions contained in federal law under the Williams Act.[513]

**5.5 Conclusion**

There are two main ways in the US in which a takeover can be completed, namely via a single-step or two-step merger. The method that will be used will generally depend upon whether the bid is hostile or friendly. For example, if the bid is hostile then the two-step method will be more appropriate. Both of the different methods are regulated by federal and state regulations. Federal laws, for the most part, regulate the process of the takeover, ensuring that a proper process is followed and that parties to the bid meet the disclosure requirements. The SEC both oversees and enforces federal regulation. By contrast, state law plays a greater role in regulating the behaviour of the target directors. These laws do this by requiring target directors to not only meet the standard fiduciary duties of loyalty, care and disclosure placed on any director making any commercial decision, but also to meet enhanced duties. These enhanced duties allow judges to scrutinise decisions made during a takeover in order to be certain that directors are acting in the best interests of the company, and not for any other self-serving reasons.

The heightened examination by judges of directors commercial decisions are justified by the courts on the grounds that takeovers put directors in an odd situation in which there may be a conflict of interest between what is best for the company and what is best for the individual director. Generally in the US, as with the UK, directors are permitted a great deal of

[512] Jonathan M Karpoff, Paul H Malatesta, 'The Wealth Effects of Second-Generation State Takeover Legislation' (1989) 25 Journal of Financial Economics 291. 299
[513] ibid



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discretion when making commercial decisions and therefore judges will not decide on the merits of those decisions. The enhanced fiduciary duties placed on target directors during takeovers, however, allow the courts to disregard this norm and decide whether the behaviour of the director was reasonable and necessary in the circumstances. Despite these enhanced duties, however, directors in the US still retain a great deal of discretion when deciding on how to deal with a takeover bid. This is evidenced by the recent “just say no” cases, in which target directors have been able to defend against unwanted takeover bids, regardless of whether the shareholders wished to sell or not, on the grounds that the takeover would be detrimental to the long-term business plans of the company. This is a divergence from the position in the UK, where directors cannot generally defend against an unwanted bid whether the takeover has merits or not.



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## Chapter Six

## US Takeover Litigation: Typology and Propensity

### 6.1 Introduction

The previous chapter described the regime that regulates the takeover process in the US. This chapter seeks to build upon this and map the litigation landscape of the US by identifying the levels of litigation that parties to a takeover in the US undertake during the takeover process. The method for gathering the data ascertaining these levels differs from that in chapter four, which used hand collected data. This chapter will instead use reliable empirical studies which have already been completed in the US, which give sufficient data for this assessment. First however, section 6.2 will discuss the types of complaints that US parties to a takeover may have, and in section 6.3 the different causes of action that might be available to them in order to pursue litigation will be outlined. Section 6.4 will then summarise the different US empirical studies completed to establish the level of litigation in the US, and section 6.5 will then discuss the findings of these studies and identify the propensity to litigate in takeovers in the US. Section 6.6 will then compare the US findings with those recorded in the UK, as outlined in chapter four. This chapter will complete the foundation required to explain the divergent levels of litigation, which will be discussed in chapter seven, and then to evaluate the impacts of the different litigation landscapes in chapter eight.

### 6.2 Typology of Range of Complaints

The range of complaints that parties to a US takeover may have are similar to those that parties to a UK takeover may have. For example, US shareholders may allege that the target directors breached their fiduciary duties. There are however, many complaints that parties to a US takeover may have that differ from their counterparts in the UK. For instance, the complex proxy rules mean that there are many opportunities for parties to complain if something is not correctly completed; a target company can also complain that a bidder has violated federal or state corporate law and thus its bid should be enjoined by the courts.[514]

[514] CN V Krishnan and others, 'Shareholder Litigation in Mergers and Acquisitions' (2012) 18 Journal of Corporate Finance 1248, 1



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These complaints are not possible in the UK because there simply are not complex proxy rules or different types of legislation, such as state or federal legislation regulating takeovers. Bainbridge notes, however, that in the US the cause of action (as long as you can show grounds for equitable relief)[515] will either be that there has been a failure to file a required document or the filings contain a material misstatement or omission.[516] The type of complaint that parties to a takeover in the US may have generally corresponds to the desired outcome of that complaint. Cain and Davidoff Solomon classified these outcomes into three categories: categories based on disclosure, amendment settlements, and consideration increase settlements.[517] Disclosure settlements are those in which the target and bidder agree to correct or provide additional disclosure to target shareholders.[518] This disclosure is typically provided to settle state law claims, and therefore complaints, by target shareholders alleging that the target directors have failed to disclose or otherwise misstates material information concerning the transaction. Complaints about inadequate disclosures can also be made regarding a failure to disclose a substantial acquisition by individuals or groups, who acquire more than five percent of the company's shares; material misrepresentations and omissions in proxy statements; if a federal procedural and disclosure requirement for a tender offer is not met; and a complaint about the breach of anti-fraud regulations if material misrepresentations and omissions in connection with the offer, including in the offering materials are made.

Amendment settlements involve a change to the deal's transaction terms, in which the original complaint may, for example, be in regard: to a reduction of the termination fee, post-sale closing limitations, extended appraisal periods, and modification or elimination of voting arrangements.[519] Consideration increases, are classified as outcomes which have monetary benefits to the target shareholders, and usually originate from complaints about the insufficient value of shares. The complaints that parties to a US takeover may have that are different from those in the UK therefore emerge from the difference in the regulatory takeover processes (i.e. how a takeover is conducted), and the other different regulatory

[515] The complainant must show that they have an implied private right of action and that they have standing to pursue such litigation under the federal regulations (as the laws governing takeover regulation in the US do not explicitly grant individual rights)
[516] Bainbridge (n302) 225
[517] Matthew D Cain, Steven Davidoff Solomon, 'A Great Game: The Dynamics of State Competition and Litigation' (2015) 100 Iowa Law Review 465. 16
[518] ibid
[519] ibid 17



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requirements imposed on each party by state and federal law. For the most part, however, complaints that arise from a takeover will be the same in both the UK and the US. This is because, despite regulatory differences, the goals of each party to a takeover largely remain the same (as discussed in chapter three).

## 6.3 Typology of the Cause of Action

The cause of action in which a party to a takeover in the US may use to further their complaint will depend upon whether they choose to litigate at the federal level or state level. This is simply because claims can be brought in either federal or state courts under the relevant legislation. This is, of course, something that cannot be done in the UK. The only choice available in the UK is whether to complain directly to the Panel or to commence litigation in the courts; however whether a claim can be commenced at court is subject to a great number of limitations.

There are three main routes in which takeover litigation can be brought as a claim in both the federal and state courts, these are: via class action lawsuits, derivative claims and individual actions. Class actions and derivative lawsuits are shareholder representative litigation, which are brought against the target board or directors for a breach of a fiduciary duty. Individual claims can be brought by the target board against the bidder's board, by the bidding board against the target board, or by the government or other bodies such as the SEC.

### 6.3.1 Federal Level Causes of Action

There are various routes in which parties can bring a claim under federal law both during and after a takeover bid; these are (as mentioned above) via a federal securities class action, a derivative claim, or via an individual action. Claims can be brought by the parties to the bid (i.e. either board or the target shareholders) against other parties to the bid or against the state of incorporation.



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Claims can be brought against either of the parties using federal securities laws such as the Securities and Exchange Act 1934 (Exchange Act), the Williams Act 1968 and via the SEC's own rules. These different pieces of legislation give significantly more causes of action for US parties to pursue their complaints as litigation than their counterparts in the UK. This is because, the behaviours these laws deal with are regulated by the Code in the UK. As explained in chapter three, the Code is a form of soft law which cannot be pursued in court. If there has been a breach of the Code, it is the domain of the Panel and not the courts to deal with such breaches. The US however relies on the courts to enforce breaches of federal (and state) regulation.

An example of some of the causes of action which parties to a takeover in the US may use are s.14(a) of the Exchange Act which sets out a mandatory disclosure process that is designed to force companies to make public the information that investors would find pertinent in making investment decisions. So for instance a claim may be brought under s.14 (a) for solicitation of proxies in violation of the rules and regulations. The Williams Act also regulates the adequacy of the disclosures mandated under federal laws; and claims may also be brought under this legislation (which amends the Exchange Act) concerning share accumulation disclosure under Section 13(d); trade secret claims; antitrust claims; and insider trading.[520] Under the SEC Rules claims may be additionally brought under sections such as 14 a-9 which deals with false or misleading statements.

Federal litigation can also be brought against the state of incorporation based on their anti-takeover statutes. This is because anti-takeover statutes can have a devastating effect in delaying and/or preventing the consummation of a hostile tender offer, and as such they are pre-empted by federal law (namely, the Williams Act) or impose unconstitutional impediments to interstate commerce.[521] Under a Supremacy Clause pre-emption analysis, if the state statute does not directly conflict with the Williams Act, then the question is whether the statute "frustrates the purposes" of the Act.[522] Pre-emption arguments often focus on the conflicts or discrepancies between these federally-regulated areas and the requirements

[520] Phillips, Krishnamurthy (n456) 21
[521] ibid 14
[522] See CTS Corporation (n335)



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imposed by the state anti-takeover statute at issue.[523] Under a Commerce Clause, attack on state anti-takeover statutes typically focuses on the potential impact of inconsistent state regulations on interstate commerce.[524] Any Commerce Clause attack on such a statute would however have to show that a state's interest in defining its corporations and protecting shareholders does not, under the circumstances, justify the statute's negative effect on interstate commerce.[525] Thus there are many causes of action under federal law, in which parties to a takeover can pursue their complaints as litigation. Table 6.1 below outlines more clearly some of the US specific complaints and corresponding causes of actions available to parties in order to pursue litigation at the federal level.

**Table 6.1**

| **Complaint** | **Cause of Action** |
|---|---|
| Non-disclosure of acquisition above 5% | s.13(d) SEA |
| Material misrepresentations and omissions in proxy statements | s.14(a) SEA |
| Breach of the federal procedural and disclosure requirements for a tender offer | s.14(d) SEA |
| Misrepresentations and omissions in connection with the offer | s.14(e) SEA |
| Mandatory SEC filings have not been made | SEC Rule 14d-1 |
| Target has not responded to the offer by filing the information required by SEC within 10 business days | SEC Rule 14d-9 |
| The offer has not been kept open for the minimum of 20 business days | SEC Rule 14e-1 |

[523] Phillips, Krishnamurthy (n456) 14
[524] CTS Corporation (n335)
[525] Arthur Fleischer Jr, Alexander R Sussman, *Takeover Defense: Mergers and Aquisitions* (6th ed, Wolters Kluwer Law & Business 2000) 4.04(B)



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### 6.3.2 State Level Causes of Action

As in the UK, US target shareholders can litigate against the target directors under state laws alleging that the directors have breached their fiduciary duties. Plaintiff attorneys can for example, allege that the target's board of directors violated its fiduciary duties by conducting a flawed sales process that failed to maximise shareholder value.[526] They can also pursue complaints regarding: the failure of the target directors to conduct a sufficiently competitive sale; the existence of restrictive deal protections that discouraged additional bids; and conflicts of interests, such as executive retention or change-of-control payments to executives.[527] Another typical cause of action under state law is that the target board failed to disclose enough information about the sales process and the financial advisor's valuation.[528] Alternatively, a bidder may file a case, claiming that a target's board of directors refused to sell the company at an advantageous price and therefore breached its fiduciary duties to its shareholders.[529] This is not something that is required of a target director in the UK. It is up to the target shareholders alone to decide on the merits of the takeover and therefore how much the shares are worth. The bidder has no recourse in the UK to allege a breach of a director's fiduciary duty, unless they are target shareholders themselves. For the most part however, if UK target shareholders feel that the company is undervalued they do not sell their shares, or vote in favour of a scheme of arrangement. Shareholders in the US can also challenge a merger or acquisition based on a specific violation of the state laws governing the organisation of the corporation, such as whether a transaction requires a shareholder vote[530] or the scope of shareholder's rights following an acquisition of shares by a potential acquirer.[531]

[526] Robert M Daines, Olga Koumrian, 'Shareholder Litigation Involving Mergers and Acquisitions' (Cornerstone Research 2013) Highlights
[527] ibid
[528] ibid
[529] Krishnan et al (n514) 1
[530] s.271(a) Delaware General Corporations Law
[531] s.1101 California Corporations Code



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## Table 6.2

| Complaint: Complainant: Target directors | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 1A. Target Shareholders | 1Ai. Identity of TS | s.13(d) SEA |
| | 1Aii. Concert party arrangements | s.13(d) SEA |
| 1B. Fellow Target Director | 1Bi. Failure to disclose information | s.13(a), s.13(d) s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor |
| | 1Bii. Merits of the bid | Directors duty of loyalty and duty of care |
| | 1Biii. Acting in concert with the Bidder | Directors duty of loyalty, duty of candor and duty of care |
| | 1Biv. Interest in bid | Directors duty of loyalty, duty of candor and duty of care |
| **Complaint: Complainant: Target directors (continued)** | | |
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 1C. Bidder | 1Ci. Breach of standstill clause | Breach of contract (specific to each governing State) |
| | 1Cii. Breach of confidentiality agreement | Breach of contract (specific to each governing State) |
| | 1Ciii. Failure to disclose or misrepresented information | s.13(d), s.14(a), s.14(e) SEA ; SEC Rule 14d-1 |
| | 1Ciii. Conflict of interest | Directors duty of care |
| | 1Civ. Breach of timetable | SEC Rule 14e-1 |
| | 1Cv. Bidder pressured TS to sell shares | |
| | 1Cvi. Extension of timetable | |
| | 1Cvii. Takeover detrimental to long term plans of the target company | |
| | 1Cviii. Breach of Regulations | s.13(d), s.13(e), s.14(a), s.14(d), s.14(e) SEA; SEC Rule 14d-1 |
| | 1Cix. Misrepresented information | s.13(a), s.14(d) SEA |
| | 1Cx. Value of bid | |
| | 1Cxi. Failure to formalise bid | |
| 1D. | 1Di. Breach of competition laws | s.7 The Clayton Antitrust Act 1914 |



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| Bidder/Government | 1Dii. TC is a 'national treasure' or 'jewel company' | |
|---|---|---|
| | 1Diii. Takeover will have detrimental effect to the economy | |
| 1E. Advisors | 1Ei. Negligent advice | Duty of care |
| | 1Eii. Conflict of interest | Duty of care |
| 1F. Regulating Body | 1Fi. Decision or ruling | Judicial Review |

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| Complaint: Complainant: Target Shareholders | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 2A. Target Director | 2Ai. TD misrepresented information | s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor |
| | 2Aii. Failure to disclose information | s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor |
| | 2Aiii. TD in conflict or not complying with takeover regulations | |
| | 2Aiv. TD valuation of the share price | Directors duty of loyalty and duty of care |
| | 2Av. TD advice on the merits of the bid | s.14(d) SEA; SEC Rule 14d-5, 14d-6; Directors duty of candor and the duty of loyalty |
| | 2Avi. TD interest in bid | s.14(d) SEA; Directors duty of loyalty, duty of candor and duty of care |
| | 2Avii. TD knew or ought to have known that the advice given to the shareholders by other professionals was negligent or misrepresentative | Directors duty of loyalty, duty of care and duty of candor |
| | 2Aviii. TD issued new shares | |
| | 2Aix. TD knew or ought to have known that bidder would strip company of assets | |
| | 2Ax. TD knew or ought to have known that the takeover was detrimental | Directors duty of loyalty, duty of care and duty of candor |
| 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority | Directors duty of loyalty and duty of care; Breach of controlling shareholders duty |
| | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted | |



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| | | |
|---|---|---|
| | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder | |
| | 2Biv. New directors/majority have stripped company of assets | |
| 2C. Advisors | 2Ci. Negligent advice | Duty of care |
| | 2Cii. Conflict of interest | Duty of care |
| **Complaint: Complainant: Bidding Company** | | |
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 3A. Target Company | 3Ai. Breach of timetable | SEC Rule 14d-9 (recommendations or solicitations by the target company or others) |
| | 3Aii. TC used takeover defence | Directors duty of loyalty and duty of care |
| | 3Aiii. TC used a disproportionate defence | Directors duty of loyalty and duty of care |
| | 3Aiv. Failure to disclosure information | s.13(a), s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor |
| | 3Av. TD refused to negotiate | Directors duty of loyalty and duty of care |
| | 3Avi. Value of bid | s.14(a), s.14(d) SEA |
| | 3Avii. TD misrepresented or did not disclose information | s.14(a) SEA; SEC Rule 14D-9 |
| | 3Aviii. TD advice to shareholders | |
| 3B. Advisors | 3Bi. Negligent advice | Duty of care |
| 3C. Regulating Body | 3Ci. Decision or ruling | Judicial Review |



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| Complaint: Complainant: Bidding Shareholders | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 4A. Bidding Directors | 4Ai. Takeover in not in the best interests of the BC | Directors duty of loyalty and duty of care |
| | 4Aii. BD did not obtain best price for shares | Directors duty of loyalty and duty of care |
| | 4Aiii. BD misrepresented information | Directors duty of loyalty, duty of care and duty of candor |
| | 4Aiv. BD advice on merits of bid | Directors duty of loyalty, duty of care and duty of candor |
| | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative | Directors duty of loyalty, duty of care and duty of candor |
| 4B. Advisors | 4Bi. Negligent advice | Duty of care |

There are similarities between the US and UK in terms of causes of action that can be used to pursue a complaint, for example the breach of a director's duty. There are however, more causes of action available to US parties to a takeover than their UK counterparts. As noted above, this is because the way in which a takeover is conducted and the behaviour expected of the parties are regulated in the US by hard laws, by legislation such as the Williams Act. This means that complaints can be pursued as litigation in the courts. Whereas in the UK similar requirements for behaviour and how a takeover is to be conducted (i.e. timetables which are to be followed) are regulated under soft laws within the Code. Whether the existences of extra rights in the US provides a good explanation as to why there are such differing levels of litigation between these two jurisdictions will be looked at in more detail in the next chapter. The next section will outline US empirical studies undertaken to ascertain these exact levels of litigation.



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## 6.4 US Empirical Studies

### 6.4.1 Cain and Davidoff Solomon

The main survey data relied on is provided by the studies of Cain and Davidoff Solomon. These studies comprise annual surveys of litigation arising from a selection of takeovers. Their original academic study 'A Great Game: The Dynamics of State Competition and Litigation' looked at takeover litigation over a period of six years from 2005 to 2011. They continued this research project by releasing preliminary statistics, and the latest results cover the year 2013-2014 (over two papers). Their sample contains all completed transactions listed in the FactSet MergerMetrics database and announced from 2005- 2014 that meet the following criteria: (i) the target is a US firm publicly traded on the NYSE, AMEX, or NASDAQ stock exchanges; (ii) the transaction size is at least $100 million; (iii) the offer price is at least five dollars per share; (iv) a merger agreement is signed and publicly disclosed through a SEC filing; (v) it was completed by 2nd January 2015. They documented all class action litigation brought in connection with a merger.[532] The sample does not include a small number of suits brought by individual activist shareholders or hostile bidders.[533]

### 6.4.2 Daines and Koumrian

The second survey relied on here is a Corner Stone Research Report completed by Daines and Koumrian. Daines and Koumrian also undertook an empirical study to determine the levels of litigation in takeover transactions in the US. The transactions of interest to their study are similar to those in Cain and Davidoff Solomon's, being of a high value. The method adopted by Daines and Koumrian however differs from the Cain and Davidoff Solomon surveys in the following ways: firstly the report looks specifically at litigation challenging merger and acquisition transactions, filed by shareholders of large US public target companies;[534] secondly the report uses a different database and method to gather its data. The report uses the Thomson Reuters' SDC database to obtain a list of all acquisitions of US

[532] Their approach captures all litigation brought in connection with a merger but excludes a small number of suits brought by individual activist shareholders or hostile bidders. Notably, we do not distinguish between whether the suit is brought as a class action or derivative claim, instead looking at all class action litigation. Nonetheless, this litigation is often pled as a direct claim due to the uncertainty of Delaware law on this issue and the ability to avoid the demand futility requirements of derivative litigation. (see Cain & Davidoff Solomon (n517) 14 at fn 9)
[533] Cain and Davidoff Solomon (n517) 14, fn9
[534] Daines & Koumrian (n526)



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public targets valued at or over $100 million announced in each year. The authors then went on to search the SEC filings of the targets and acquirers for discussion of shareholder litigation. After the deals were closed, they used court dockets to trace litigation outcomes.[535]

This second study compliments Daines and Koumrians' surveys, which give a good overall picture of the litigation undertaken in takeovers, because it allows a more focused look at the litigation of target shareholders. In the US target shareholders, as will be explained below, are the parties to a takeover who are the instigators of takeover litigation.

## 6.5 Propensity to Litigate

### 6.5.1 Cain and Davidoff Solomon's Findings

**Figure 6.1**

*Table A: Litigation rates over time*

| Deals | | Litigation | % with litigation |
|---|---|---|---|
| 2005 | 183 | 72 | 39.3% |
| 2006 | 232 | 99 | 42.7% |
| 2007 | 249 | 97 | 39.0% |
| 2008 | 104 | 50 | 48.1% |
| 2009 | 73 | 62 | 84.9% |
| 2010 | 150 | 131 | 87.3% |
| 2011 | 128 | 117 | 91.4% |
| 2012 | 121 | 111 | 91.7% |
| 2013 | 118 | 110 | 93.2% |
| 2014 | 79 | 75 | 94.9% |
| Total | 1,437 | 924 | 64.3% |

*Cain & Davidoff Solomon 2015

[535] Daines & Koumrian (n526) Highlights



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Out of the 79 transactions Cain and Davidoff Solomon recorded in 2014, 75 of these involved litigation. In percentage terms the findings record that almost 94.9 percent of takeovers in 2014 involved litigation.[536] The preliminary statistics they recorded in 2015 however show a slight decline in rates of takeover litigation from 94.9 percent in 2014 to 87.7 percent.[537] These rates however still remain high, and it is certain that if a target announces a takeover (with a value over $100 million) it should be assumed that it and its directors will be sued.[538]

Cain and Davidoff Solomon's study shows that takeover litigation has reached a "steady-state" where almost every deal valued over $100 million experiences litigation. For the fifth year in a row around 90 percent of transactions experienced a lawsuit. The higher figure continues the increasing trend of their recorded takeover litigation which is now brought at a rate almost 2.5 times that of 2005.[539]

In respect of settlement information, Cain and Davidoff Solomon's data is only preliminary because, as they explain, many of the cases recorded are still currently making their way through the courts.[540] They have however found that more than 70 percent have settled so far.[541] Nearly 85 percent of these settlements were disclosure only, which typically resulted in an amendment to the company's proxy statement to provide additional disclosure to target shareholders, who are not paid any amount in this type of settlement.[542]

These findings show that there is a significant difference between the levels of takeover litigation brought in the US as compared to the UK. During the period of 2010 to 2014 in the UK less than one percent of takeover litigation was brought. In the same period Cain and

[536] Cain, Davidoff Solomon (n517) 2
[537] Matthew D Cain, Steven Davidoff Solomon, Takeover Litigation in 2015 (Berkeley Center for Law, Business and the Economy, January 2016) <https://ssrn.com/abstract=2715890> accessed 10 February 2016 (The fall in litigation rates comes at a time when the Delaware courts have begun to challenge meritless takeover claims, particularly disclosure claims. This will be discussed further in chapter seven and eight).
[538] Cain, Davidoff Solomon (n537) 2
[539] ibid
[540] ibid 5
[541] ibid 4
[542] Steven Davidoff Solomon, 'Corporate Takeover? In 2013, a Lawsuit Almost Always Followed' *The New York Times* (10 January 2014) <http://dealbook.nytimes.com/2014/01/10/corporate-takeover-in-2013-a-lawsuit-almost-always-followed/?_r=1> 7 September 2014



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Davidoff Solomon recorded that around 90 percent of takeover transactions experienced litigation. There is however a limitation to Cain and Davidoff Solomon's data which may lead to a biased result. The transactions that were of interest to them, as already noted, were those valued over $100 million. When analysing takeover litigation it is important to consider both smaller offers as well as larger offers. This is because higher valued transaction may experience more litigation because there is more at stake. The data collected for the UK did not have such a limitation and therefore it makes the figures difficult to accurately compare.

Krishnan et al, who also carried out an empirical study on the levels of takeover litigation in the US looked at both high value and low value takeover transactions and the levels of litigation experienced by each. To do this they segregated offers into either large or small offers, defined as offers above and at or below the median offer size of $80 million, respectively.[543] Their study found that less than 12 percent of all offers are subject to takeover litigation.[544] Their data however also has a limitation because it was collected from the period 1999 to 2000, which means that their findings are also not comparable to the litigation data collected for the UK. This is because the levels of litigation experienced in takeovers of all values have significantly increased after the 2008 post-financial crisis period.[545]

Therefore it seems as if there is no data available to ascertain the actual levels of litigation in the US of takeovers of both low and high value transactions in recent years. If Krishnan et al's findings are applied to Cain and Davidoff Solomon's; however some rudimentary figures can be calculated which can be compared to the UK data. For instance, Krishnan et al found that 18.73 percent of the high value transactions they recorded experienced litigation, compared to low value transactions which experienced 5.09 percent. This is nearly a 14 percent difference, and concludes that at this time, high value transactions experienced over three times more litigation than lower value transactions.

[543] Krishnan et al (n514) 24
[544] ibid 20
[545] CN V Krishnan and others, 'Jurisdictional Effects in M&A Litigation' (2014) 11 Journal of Empirical Legal Studies 132, 133; see also Daines, Koumrian (n526); Cain & Davidoff Solomon (n517)



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**Table 6.3**

| | % |
|---|---|
| Litigation in high value deals (>$80mil) | 18.73 |
| Litigation in small value deals (<$80mil) | 5.09 |

Using this data, it can therefore be assumed that takeover litigation is 3.68 times more likely to occur in larger transaction deals than in smaller deals. Consequently if Cain and Davidoff Solomon's findings that 91.7 percent of high value transactions from the period of 2010 to 2014 experienced litigation is divided by 3.68, it can be assumed that during the same period almost 25 percent of all transactions experienced litigation. This figure of 25 percent, although rudimentary, shows that there is still significantly more litigation in takeover transactions in the US than in the UK.[546] Even comparing Krishnan et al's findings that just less than 12 percent of all transactions experience litigation demonstrates that the propensity for takeover litigation is greater than in the US than the UK.

546 We must also bear in mind that Krishnan et al's assessment of high valued transactions are marginally different from Cain and Davidoff Solomon's ($80mil vs $100mil, respectively).



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6.5.2 Daines and Koumrian's Findings

**Figure 6.2**

REVIEW OF LITIGATION
M&A DEALS VALUED OVER $100 MILLION

| | ACQUISITION ANNOUNCEMENT YEAR | | | |
|---|---|---|---|---|
| | 2009 | 2010 | 2011 | 2012 |
| Number of lawsuits filed | 349 | 792 | 742 | 602 |
| Percentage of deals litigated | 86% | 90% | 93% | 93% |
| Average number of lawsuits per deal | 4.3 | 4.9 | 5.3 | 4.8 |
| Average number of days between deal announcement and lawsuit filing | 14 | 16 | 17 | 14 |

Source: Thomson Reuters' SDC; SEC filings; dockets

Note: The data include shareholder lawsuits related to acquisitions of U.S. public companies valued at or over $100 million.

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Continuing a recent trend, Daines and Koumrian found that shareholders challenged the vast majority of takeover deals in 2012.[547] Among deals valued over $100 million, 93 percent were challenged, with an average of 4.8 lawsuits filed per deal.[548] The data in the report showed that lawsuits were filed an average of 14 days after the merger announcement, with plaintiff firms sometimes announcing investigations within hours of the merger announcement.[549] For deals valued over $500 million, 96 percent of target firms reported deal-related litigation in their SEC filings, with an average of 5.4 lawsuits per deal.[550] Most cases settled, and in more than 80 percent of settlements the only relief to shareholders was additional disclosures.[551]

547 Daines, Koumrian (n526) 1
548 ibid
549 ibid
550 ibid
551 ibid 6



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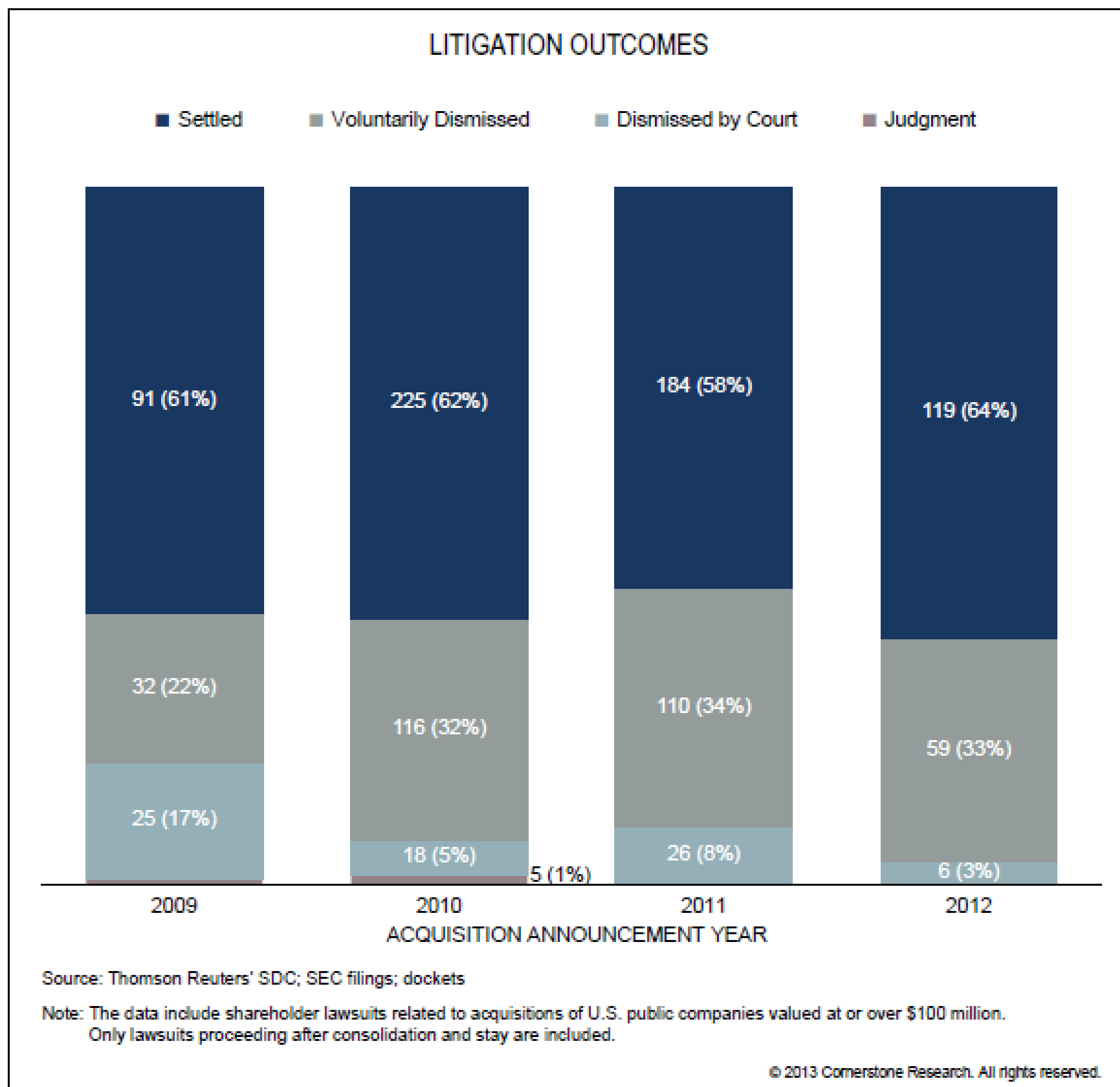
**Figure 6.3**




Daines and Koumrian were also able to determine the outcome of 182, or 58 percent, of the consolidated lawsuits related to 2012 deals.[552] Plaintiffs voluntarily dismissed 59 lawsuits, and the court dismissed six cases. The majority (119) of the 2012 lawsuits settled. The settlements occurred before the deals closed and an average of 42 days after the lawsuits were filed. Most 2012 settlements resulted only in additional disclosures and fees awarded to plaintiff attorneys. The 119 settling lawsuits resulted in 67 unique settlements (several awarded lawsuits often settle together). Of the 67 settlements, shareholders received supplemental disclosures (and nothing else) in 54 settlements (81 percent), and the parties in

[552] Daines, Koumrian (n526) 5



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only one settlement acknowledged that litigation contributed to an increase in the merger price. Additionally, the deal termination fee was reduced in four cases and the parties reached agreements about appraisal rights in six cases.[553]

**Figure 6.4**

SETTLEMENT TERMS

| | ACQUISITION ANNOUNCEMENT YEAR | | | |
|---|---|---|---|---|
| | 2009 | 2010 | 2011 | 2012 |
| Total number of settlements | 57 | 113 | 101 | 67 |
| Additional disclosures only | 43 | 86 | 89 | 54 |
| As % of all settlements | 75% | 76% | 88% | 81% |
| Monetary benefit | 5 | 8 | 4 | 1 |

Source: Thomson Reuters' SDC; SEC filings; dockets

Note: Data include lawsuits related to M&A deals valued at or over $100 million.

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Most of the large settlements included allegations of significant conflicts of interest, such as: target companies' managements negotiated premiums for share classes they held; the target companies' chief executive officers negotiated side deals with acquirers to purchase some of the targets' assets; the majority shareholders gained ownership of the remaining shares in the companies at allegedly unfair terms; the target companies' financial advisors had conflicts of interest. Only two of the settlements recorded by Daines and Koumrian did not involve allegations of specific, significant conflicts of interest.

## 6.6 Comparative Analysis

Based on the data recorded in the empirical studies there is a greater propensity to litigate in the US than in the UK. The exact degree of difference is however difficult to ascertain. It ranges from a significant one when looking at Cain and Davidoff Solomon, and Daines and Koumrian's' studies, to a smaller but still higher propensity to litigate when considering Krishnan et al's data. Using the data collected in Krishnan et al's study however, it can be

[553] Daines, Koumrian (n526) 6



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assumed that takeover litigation is nearly four times more likely to occur in larger transaction deals than in smaller deals. Consequently if Cain and Davidoff Solomon's findings that 91.7 percent of high value transactions from the period of 2010 to 2014 experienced litigation is divided by 3.68, it can be assumed that during the same period 25 percent of all transactions experienced litigation. This figure of 25 percent, although rudimentary, shows that there is still significantly more litigation in takeover transactions in the US than in the UK.[554] In the UK only 0.27 percent of the takeovers recorded in chapter four experienced litigation. That means the US experiences 92 times more litigation in takeovers, even when considering more conservative figures.

US takeover litigation is almost always brought as a class action case on behalf of target shareholders who request additional disclosures to be made.[555] In the UK both the target shareholder and the bidder commence an almost equal amount of litigation. Shareholders generally allege unfair prejudice or a breach of a director's duty, and bidders usually bring claims against other third parties, such as advisors regarding conflicts of interest. Around 27 percent of takeover litigation in the UK is successful, in that the claimants won their claim, even though they may not have always achieved the outcome of the litigation which they desired. Cain and Davidoff Solomon's original data, collected from 2005 to 2011, shows that 28.4 percent of cases are dismissed by the court, and that the other 71.6 percent of cases result in some type of settlement. It therefore seems that takeover litigation in the US is more likely to succeed.

However, it depends on how success is defined because 55.1 percent of the settlements recorded were disclosure only settlements which brought no monetary benefit to the shareholders. 1.2 percent of the claims involved an amendment settlement and only 4.8 percent provided an actual monetary benefit. Daines and Koumrian recorded similar figures in their study. They found that of the total cases they documented that settled 81 percent of these were disclosure only settlements (82.6 percent of settlements were disclosure only in

[554] Again, we must bear in mind that Krishnan et al's assessment of high valued transactions are marginally different from Cain and Davidoff Solomon's ($80mil vs $100mil, respectively).
[555] Cain, Davidoff Solomon (n517) 13



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2014).[556] Daines and Koumrian however noted that when there was a settlement involving a monetary benefit that the amount of money awarded has increased in size over a 10 year period between 2002 and 2012. The average settlement fund between 2010 and 2012 was $87 million, compared with $36 million in 2003 through 2009.[557] The large settlements generally included claims of allegations of significant conflicts of interest.[558] Outcomes of litigation in UK are much more varied than those in the US, for example injunctions were granted by the courts, requests for identity of shareholders were made, freezing orders were requested to be lifted, and parties (such as advisors) were asked to be removed from the takeover process. Damages for breaches of duty of care were also rewarded. The majority of US litigation however seems to be based on information-forcing. Once those cases are stripped away there are only a small number of cases involving litigation which results in an amendment to the takeover agreement or in a monetary benefit. These cases, looking at Cain and Davidoff Solomon's data, only amount to six percent of the overall litigation recorded.

### 6.7 Conclusion

This chapter and chapter four have mapped the litigation landscapes of the UK and US, and have established that there are low levels of litigation in the UK compared to high levels in the US. These chapters therefore confirm that there is a significant divergence in the levels of takeover litigation in these two jurisdictions.

Cain and Davidoff Solomon find that 91.7 percent of high value transactions from the period of 2010 to 2014 experienced litigation. This figure is also reflected in the findings of Daines and Koumrian who found that 93 percent of the transactions they recorded involved litigation commenced by the target shareholders. Based on this data it is clear that there is a greater propensity to litigate in the US than in the UK. The degree of difference is however difficult to ascertain due to the differences in the transactions recorded in the UK (with the US studies targeting high valued transaction only compared with all values of transactions which were of interest in the UK study). Even when considering a more conservative figure, which was calculated using data from an older study which recorded lower value takeovers, US parties

[556] Daines, Koumrian (n526) 7
[557] ibid
[558] ibid 8



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to a takeover are still 92 times more likely to commence takeover litigation than their UK counterparts.

This chapter showed that US takeover litigation is almost always brought as a class action case on behalf of target shareholders who request additional disclosures to be made.[559] In the UK both the target shareholder and the bidder commence an almost equal amount of litigation. Shareholders generally allege unfair prejudice or a breach of a director's duty, and bidders usually bring claims against other third parties, such as advisors regarding conflicts of interest. As such there is not only a difference in the levels of litigation brought in the US and UK but also a difference in the motivations for bringing the claims. US litigation seems to solely revolve around information forcing as very few cases settled for amendments to the takeover agreement or for a monetary benefit.

[559] Cain, Davidoff Solomon (n517) 13



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## Chapter Seven

## Explaining the Litigation Landscapes of the UK and US

### 7.1 Introduction

Chapters four and six sought to describe, or to "map," the takeover litigation landscapes of the UK and the US. This chapter now turns from description to *explanation*: why is it that the US has so much more (of certain types of) takeover litigation than the UK does? The difference, however, is not the only thing of interest here; *shared* features are also worthy of some explanation. As an analogy, an explanation of two geographical landscapes would be considered rather limited if it explained only the presence of a mountain in one landscape and its absence in the other, whilst making no attempt to explain the large flatlands that both landscapes also shared in common. The difference between the two landscapes is easily restated here: in the US, target shareholders almost always sue their own directors regarding their conduct during a takeover (mainly alleging that information has not been disclosed); in the UK, target shareholders very rarely do so. Since this is the essential difference between the two regimes, to avoid repetition this will be labelled the "TSvTD spike."[560] As noted, the explanation of this key difference is the primary focus of this chapter.

This chapter offers four candidates for explaining the TSvTD spike. They are considered in turn through sections 7.2-7.5. None of these candidates alone is sufficient to explain the TSvTD spike, but in fact all do contribute towards a full explanation. It is the combination of these four 'explanatory candidates,' and key differences between the UK and the US that each one captures that together fully and convincingly explains the TSvTD spike. My thesis thus rejects a simplistic uni-causal explanation. The explanation is, perhaps predictably, more complex, but better able to capture the full range of matters that together encourage takeover litigation in the US but suppress it in the UK. This chapter does not attempt to model the impact of removing any one of the differences that constitute the explanatory candidates. Certainly, it is implicit in my account that changing any of them would indeed have an impact, and would likely reduce (but not eliminate) the magnitude of the difference between UK and US takeover litigation rates. But calculating the precise extent of that impact is beyond this work.

[560] "Target shareholders versus target directors"



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The first explanatory candidate, in 7.2, considers the possibility that target shareholders in the US have more 'causes of action' available to them than do UK shareholders. As with the other three explanatory candidates, it is argued that this has some validity. However, it is important to identify precisely how US shareholders benefit from more extensive 'causes of action'. They do so in two ways. First, the statutory obligations (such as the disclosure obligation) of US directors are more *demanding* than the obligations to which UK directors are subject during a takeover. Secondly and much more significantly however, is that the *beneficiaries* of these more demanding obligations also differ between the two jurisdictions. Crucially, the relevant US duties of disclosure are owed *directly to the shareholder*. This is in complete contrast to directors' duties in the UK, which are owed only to the company and not directly to the shareholders. It is this difference in the identity of the beneficiaries of the disclosure obligations (and, therefore, of who is entitled to bring an action for a breach of them) that matters most here in understanding this first candidate for explaining the TSvTD spike.

The second explanatory candidate, examined in 7.3, is the different 'forms of action' available in the UK and US. By 'forms of action' it is meant, the procedural tools that target shareholders can use to enforce whatever causes of action may exist. Thus, forms of action would include representative actions, class actions, derivative claims, and so on. In the US, target shareholders prefer to use the class action as a means of enforcing disclosure obligations owed by target directors.[561] It is this procedural device, especially when understood in the context of the rules governing attorneys' fees, which provides the reservoir feeding the flow of US takeover litigation. This, however, does not necessarily entail that it is the *absence* of such a device in the UK which explains the absence of the litigation mountain in the UK. Even if the UK were to permit class actions, it would not necessarily follow that this would result in a surge of UK litigation comparable to the TSvTD spike seen in the US. The reason this is so takes us to the third explanatory candidate.

The third candidate, addressed in 7.4, concerns the role played by the existence of the Code, and its administration by the Panel. It is argued that these UK institutions do much to

[561] Shareholders in the US are directly owed a duty of disclosure by their directors, as such they are not forced to bring a derivative claim to enforce a breach of a directors' duty.



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suppress takeover litigation in general, including (crucially for the argument that is the focus of this work) litigation by target shareholders against target directors. The presence of the Panel and the Code in the UK both disincentivises, and sometimes even entirely precludes, takeover litigation, in a number of ways. Firstly, the Panel plays a significant role in solving disputes, and as such provides an efficient alternative to litigation and the Code manages the behaviour of the directors. Secondly, the reverence given to the Panel by the courts means that judges are extremely hesitant to play a role in the regulation of takeovers. Thirdly, the no frustration principle prohibits target company tactical litigation that has not been approved by the target shareholders. The absence of such a body as the Panel in the US explains why parties to a takeover rely heavily on the courts for any resolution of disputes. Thus, even if the UK introduced both a direct statutory directors disclosure obligation owed to target shareholders, and a class action device similar to that in the US (and even if that operated with the same generous fee awards for lawyers as seen in the US), there still would not be comparable levels of litigation in the UK.

The fourth candidate, discussed in 7.5, is the rather amorphous concept of "litigation culture." The section begins by clarifying what is meant by this concept, as the term is sometimes used merely as a convenient label to describe (but not to explain) an abundance of litigation. Such a usage is, clearly, inappropriate here, in what is an explanatory chapter. Instead, the term is used here to capture other features of the economic or social environment, of the UK and of the US, which might offer explanations for the TSvTD spike. What these features might be are identified, and then considered as to whether any of them are likely to make a real difference to litigation rates in the two jurisdictions. Some features, such as the US being more prone to litigation due to an aggressive nature, or having more lawyers, do not seem to provide a plausible explanation. The existence of the Code in the UK, and its creation of both an alternative means of disciplining target directors and a climate in which allegations of misbehaviour by target directors are expected to be settled through the Code/Panel, are essential elements of the specifically-takeover related culture in the UK. Other elements such as the acceptability of litigation in the US takeover process may be a factor in explaining the disparity. These cultures have been determined by the structural components of the US and UK systems, and therefore it is these components that constitute the ultimate explanation for the litigation landscapes of the UK and US.



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### 7.2 Differences in "Causes of Action" in the UK and US

The degree to which shareholders in the UK and the US enjoy a cause of action in respect of alleged misbehaviour by their directors will depend on two different ingredients. The first is the 'extent' of the obligations or duties owed by the directors. The more extensive these obligations (for example, the more bits of information directors are required to disclose) the more likely, all other things being equal, that directors will be in breach, and therefore liable to litigation against them. The second ingredient is the identity of the party to whom such duties are owed. If the duties are not owed to shareholders themselves, but instead are owed only to the company (or if the obligations are owed only to the state, and punishable only by criminal proceedings), then *shareholders* would enjoy no cause of action, regardless of however extensive the underlying obligations might be.

The task, then, is to compare the causes of action enjoyed by shareholders in each jurisdiction. In respect of the first ingredient, the obligations on directors (and especially the disclosure obligations) are indeed more extensive in the US than the UK. However, we shall also see that, in respect of the second ingredient (that is, the *identity* of the beneficiary of the obligations) there is a much more significant difference between the jurisdictions. US disclosure obligations, in particular, are owed directly to, and enforceable by, shareholders. In the UK, the general rule is that they are owed only to the company itself.

#### 7.2.1. Are the Obligations of (Target) Directors More Extensive in the US than the UK?

In this section, we consider whether the obligations on target directors are more extensive in the US than in the UK.

#### 7.2.1.1 A Red-Herring: Some Additional, but Irrelevant, US Regulatory Obligations

This section begins by addressing what is, in truth, a "red herring." It concerns some ways in which the US takeover regime does indeed seem to impose additional obligations on parties to takeovers compared to those in the UK. These particular additional obligations, however,



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actually generate very little litigation, and therefore are in fact quite irrelevant to the specific TSvTD spike which we are seeking to explain.

Table 7.1, below shows five complaints where there exist relevant legal obligations in the US but which are covered by no equivalent legally enforceable obligations in the UK.

**Table 7.1**

| | **Complaint** | | **Potential Cause of Action** | |
|---|---|---|---|---|
| **Complainant** | **Target of Complaint** | **Substance of Complaint** | **UK** | **US** |
| Target Directors | Bidder | 1Ciii. Failure to disclose or misrepresented information | | s.13(d), s.14(a), s.14(e) SEA ; SEC Rule 14d-1 |
| | | 1Civ. Breach of timetable | | SEC Rule 14e-1 (minimum tender offer period) |
| | | 1Cviii. Breach of takeover regulations | | s.13(d), s.13(e), s.14(a), s.14(d), s.14(e) SEA; SEC Rule 14d-1 |
| Bidding Company | Target Company | 3Ai. Breach of timetable | | SEC Rule 14d-9 (recommendations or solicitations by the target company or others) |
| | | 3Avii. TD misrepresented or did not disclose information | | s.14(a) SEA; SEC Rule 14D-9 |

At first sight, it might easily (but in fact wrongly) be assumed that these various legal obligations must have led to an increase in the level of US litigation, and therefore explain the TSvTD spike. What is important in explaining the differing propensities to litigate however is to ascertain whether these five “extra rights” in the US actually generate the high levels of litigation?



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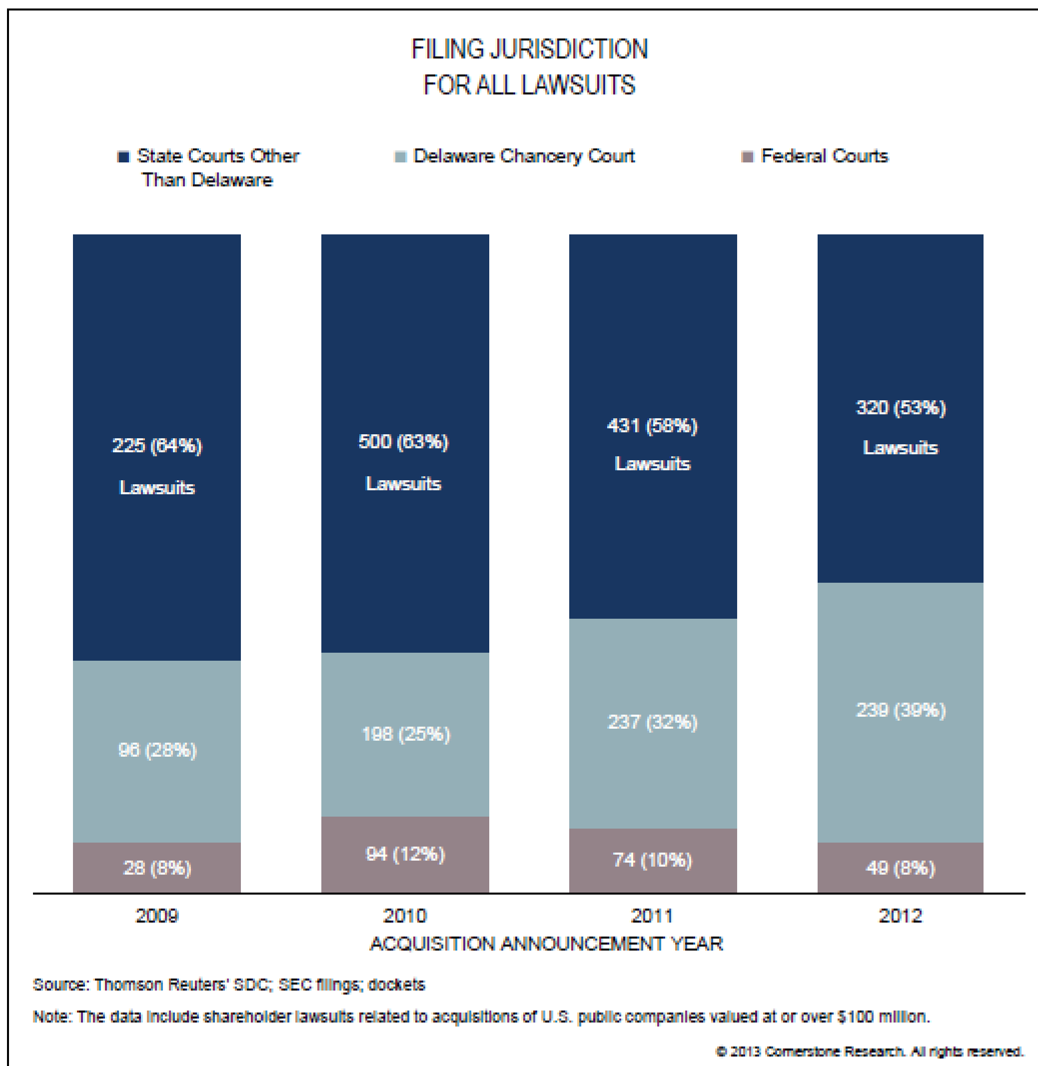
The answer is no, and for two reasons. Firstly, and most importantly, these extra obligations do not generate the litigation which makes up the TSvTD spike. The obligations set out in Table 7.1 are required to be undertaken between the target company and the bidder. They do not include obligations owed by target directors to target shareholders. Secondly, the federal regulation as noted above does not generate high levels of litigation. The graph below, taken from the Corner Stone Research conducted by Daines and Koumrian, illustrates that only a small percentage of takeover litigation in the US is brought under federal causes of action.

**Figure 7.1**



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The graph reveals that over a four year period only eight to 12 percent of all takeover litigation in the US is brought to the federal courts using federal causes of action.[562]

7.2.1.2 Relevant Ways in Which Target Directors' Obligations *are* More Extensive in US

As noted before, the complaints that do make up the TSvTD spike concern allegations against target directors (by target shareholders), i.e. that a target director has breached a duty. This could be a duty of disclosure, or some other duty. So, for example, target shareholders may:

*'challenge the target director's substantive and procedural fairness in the takeover, typically encompassing possible conflicts of interest, failure to shop the company adequately or otherwise maximise the sales price, or concerns about provisions in the merger agreement such as termination fees.'*[563]

It is true that directors in both the UK and the US owe obligations with regard to disclosure, conflicts of interest, and the like. However, as we shall now see, those owed by directors in the US are rather more intense/demanding than their UK equivalents. This difference in the intensity of the obligations is most pronounced in respect of the *disclosure* obligations imposed on US directors, and especially those imposed by state law, rather than by federal law.[564] The TSvTD spike is, as we have seen, constituted primarily of actions alleging that target directors have breached their state law duty of disclosure to shareholders.[565] Target shareholders however tend to allege a breach of disclosure rather than a breach of duty of loyalty or care, because it is easier to demonstrate that a director has not met their obligations under this duty.[566]

[562] What is not clear from the graph is whether the five extra rights highlighted in Table 7.1 form a significant part of this federal takeover litigation. Despite this, even taken together the total number of federal cases is not significant enough to conclude that these extra rights explain the substantial difference in takeover litigation levels between the UK and US.
[563] Jill E Fisch, Sean J Griffith, Steven Davidoff Solomon, 'Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform.' (2015) 93 Texas Law Review 557, 599
[564] ibid 613, see also Elliott J Weiss, Lawrence J White, 'Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law' (1987) 75 California Law Review 551, 572
[565] ibid 598
[566] See ibid



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The Delaware fiduciary duty to disclose was created by the courts.[567] The pivotal case in the development of this duty is Smith v Van Gorkom.[568] In this case the court held that a board had breached its fiduciary duty, because it had failed to disclose all material facts, which it knew or should have known, before securing the shareholders' approval of a merger.[569] The board, during a takeover or merger, is therefore responsible for providing shareholders with sufficient information to approve or reject a transaction on an informed basis.[570] The motive of the director in deciding not to disclose information is irrelevant; therefore there is no need for the claimants to prove that the director acted fraudulently or dishonestly.[571]

Delaware judges interpret the term "material" in quite broad terms, noting that 'the materiality of non-disclosure facts is a mixed question of law and fact.'[572] In Weinberger v Rio Grande Industries the court confirmed Lynch v Vickers,[573] stating that it is 'now [a] well-settled rule of Delaware law that corporate directors owe the corporation's stockholders a fiduciary duty to disclose all facts germane to a transaction involving stockholder action, in an atmosphere of complete candor.'[574] The courts have defined "germane" in the tender offer context as all 'information such as a reasonable stockholder would consider important in deciding whether to sell or retain stock.'[575] The standard *does not* require that the non-disclosure would have caused a reasonable investor to change their vote, but only that the statement be relevant to a reasonable shareholder.[576] The test is objective as to whether the information would have been important from the perspective of the shareholders.[577] Therefore non-disclosure from a non-interested director acting in good faith could still be in breach of this duty for not disclosing information in their control, if it would have been

[567] This state fiduciary duty to disclose was only created in the last three decades; see Strine et al (n403); Jeffrey Gorris, Leo Strine, Lawrence Hamermesh, R. Franklin Balotti, 'Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law', vol 5349 (2009) 630.
[568] (n375)
[569] See chapter five section 4.3.2
[570] Fisch et al (n563) 565; see also Smith v Van Gorkom (n375) (which held that a board had breached its fiduciary duty by failing to disclose the parameters of the negotiations leading to the company's sale. at 890–92)
[571] Smith v Van Gorkom (n375) 873-874
[572] Glassman v Wometco Cable Tv inc Civ Act No 7307 1989 Delaware Chancery LEXIS 1 (Jan 6, 1989)
[573] 383 A2d 278 (1977)
[574] 519 A2d 116 (1986) at 121
[575] Weinberger (n430) [710]; see also Michelson v Duncan Delaware Supreme Court 407 A2d 211 (1979); Schreiber v Pennzoil Corp Delaware Chancery, 419 A2d 952 (1980)
[576] See Red Oak v Digirad 2013 WL 5740103 (Delaware Chancery Oct 23, 2013)
[577] See Smith Van Gorkom (n375) at 893 ('by their failure to disclose all material information such as a reasonable stockholder would consider important')



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relevant to a reasonable shareholder in making a decision to vote, even if that information ultimately would not have affected the way in which they would have voted.

Delaware judges consequently apply disclosure requirements 'in the fact-specific context of individual transactions'[578] giving greater flexibility to the courts to determine whether information is indeed required to be disclosed. This standard of disclosure is even far greater than that required under federal law which contain 'prescriptive rules of general application.'[579] Consequently it could be difficult for a claim of non-disclosure to be dismissed before it reaches trial.[580] Under federal law, 'the failure to disclose even material information is not actionable unless SEC rules specifically mandate disclosure of that information or unless the omission renders other disclosures misleading.'[581] The 'failure to include all material information in a proxy statement does not violate federal law.'[582] For example, as Fisch et al note:

> '*[F]ederal law requires the disclosure of "material relationships" existing between the advisor and the other party in the transaction over the prior two years, but several Delaware decisions have compelled considerably more detailed disclosure about investment banker relationships and potential conflicts.*'[583]

In *El Paso*,[584] Chancellor Strine remarked that a target company's financial advisor's failure to disclose a personal ownership of $340,000 in the bidder's stock to the target shareholders was "very troubling;"[585] even though it is 'unclear that disclosure of this interest was required under federal law.'[586]

[578] Fisch et al (n563) 594; see also David Friedman, 'The Regulator in Robes: Examining the SEC and the Delaware Court of Chancery's Parallel Disclosure Regimes' (2013) 113 Columbia Law Review 1543
[579] Fisch et al (n) 594; see also Friedman (n578) 1553 ('[T]he fact-specific nature of Chancery decisions differentiates them from the broad, prospective rules typically generated by regulatory agencies.')
[580] See Glassman (n572) 'The materiality of non-disclosure facts is a mixed question of law and fact and as such is not usually an appropriate issue for summary judgment'
[581] Resnik v Swartz 303 F3d 147 151 n2 (2d Cir 2002)
[582] See Perelman v Pa Real Estate Inv Trust 432 F Supp 1298 1304 (ED Pa 1977)
[583] Fisch et al (n563) 595; see also Friedman (n578) 1556–58
[584] In re El Paso Corp Shareholder Litigation 41 A3d 432 (Delaware Chancery 2012); see also Friedman (n578) 1553
[585] Friedman (n578) 442
[586] Fisch et al (n563) 595; see also ibid



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This section now turns to analyse and compare the equivalent obligations owed by UK directors. There is no specific fiduciary duty to disclose in the UK, and under s.956 of the CA it is noted that a contravention of any rule-based requirement under the Code, including a disclosure requirement, does not give rise to any right of action for breach of statutory duty. A target directors' non-disclosure would therefore only become actionable if it amounted to a breach of a UK statutory obligation, such as a breach of a directors' duty under the CA or a breach of s.90 Financial Services and Markets Act 2000 ("FSMA"). There are three possible duties which may be breached if a director does not disclose material information during a takeover, these duties are: s.172 to promote the success of the company; s.174 to exercise reasonable care, skill and diligence; and s.175 to avoid conflicts of interest. A target shareholder will however find it difficult to demonstrate a breach of these duties in the UK.

The duty to promote the success of the company requires a director to act in a way that they consider, in good faith, to be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard to other factors, such as long-term strategies and the interests of stakeholders.[587] It is said to be 'probably the most wide-ranging duty of the general duties in the Act, and clearly the most difficult to interpret.'[588] The understanding of the legislative development of this duty is that it is 'meant to focus directors' attention on the long-term interests of the company, and not just short-term profit maximisation.'[589] The duty is also meant to have an impact on the way in which directors behave, including the way in which they make decisions.[590] It is comparable to the US directors' duty of loyalty;[591] from which the current US disclosure obligations were conceived. It would therefore seem reasonable for a UK target shareholder to bring a complaint regarding non-disclosure under the grounds set out in s.172. The way in which the courts have deliberated over the application of this duty suggests that, even though it is wide ranging in scope, it is actually very difficult to establish that a director has in fact breached this duty.

[587] s.172 CA
[588] Andrew Keay, 'The Duty To Promote the Success of the Company: Is It Fit for Purpose?' (2010) University of Leeds School of Law, Centre for Business Law and Practice Working Paper 1, 4
[589] ibid 10
[590] Company Law Review, Modern Company Law for a Competitive Economy: The Strategic Framework (1999) London DTI para 5.1.17.
[591] Discussed in chapter five section 4.3



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The directors' actions will be judged as 'bona fide in what they consider, not what a court may consider is in the interest of the company.'[592] As such the court will not impose their own views in considering what was reasonable in the particular situation before them, as long as the director honestly believed the action to be in the best interests of the company.[593] Consequently, the bar is set remarkably high for target shareholders to prove that a director deliberately did not disclose material that would be in the best interests of the company to have disclosed. It is 'likely to be difficult to demonstrate, save in cases of really bad behaviour, that the directors have breached their duty of good faith.'[594]

There are also difficulties for target shareholders to establish a breach of s.174, which requires directors to exercise reasonable care, skill and diligence when making decisions.[595] This means the care, skill and diligence that would be exercised by a reasonably diligent person with: the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions of a director in relation to the company, and; the general knowledge, skill and experience that the director has.[596] A target shareholder could potentially bring a claim for a breach of this duty if a director failed to disclose pertinent information regarding a bid. However, as with s.172, demonstrating a breach of this duty is difficult. This is because the courts are reluctant to find directors liable for breaching this duty,[597] and are often cautious about judging directors harshly when making business decisions.[598]

Finally, the duty under s.175 requires directors to declare any interests they may have in a proposed transaction or arrangement, whether that interest is direct or indirect. This provision ensures that directors are not in conflict with the company and do not exploit company opportunities for their own benefit. This fiduciary duty of disclosure is very limited in scope compared to that created by the US courts. For instance, a director need not declare an interest in the UK if it cannot be reasonably regarded as likely to give rise to a conflict of

[592] Re Smith & Fawcett Ltd (n241) Per Lord Greene MR [306]
[593] Regentcrest plc v Cohen [2002] 2 BCLC 80 [90]
[594] Keay (n588) 14
[595] s.174(1) CA
[596] ibid s.174(2)
[597] See Chris Riley, 'The Company Directors' Duty of Care and Skill : The Case for an Onerous but Subjective Standard' (1999) 62 The Modern Law Review 697.
[598] See Regentcrest v Cohan [2001] 2 BCLC 80; Hedger v Adams [2015] EWHC 2540 (Ch) at 44



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interest; or if the other directors were already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware).[599] There are also ex-ante and ex-post shareholder approval mechanisms to approve a transaction even if a director is in conflict with a takeover.[600] For example, under s.239 CA shareholders can vote to ratify a director's action or omission that was in breach of their duties.

7.2.2. The Key Difference: to whom are these Duties Owed?

The underlying statutory obligations of directors during a takeover are therefore greater in the US than the UK. However, whilst disclosure claims constitute a majority of the TSvTD spike, the differences in the extent of the obligations do not seem to sufficiently explain away the size of the spike. It is not as if the obligations on UK directors are so much weaker than their US equivalents that an allegation of breach is never likely to be plausible, and yet actions are almost never likely to be brought in the UK.

Much more significantly, however, is not the extent of the obligations, but the identity of the party to whom they are owed, and who can therefore enforce them? Starting with the US, the directors' disclosure obligations are based upon a director's fiduciary duty in relation to both the corporation, and more crucially, its shareholders.[601] The US statutory duty of disclosure is therefore owed directly to the shareholders, as laid down in Lynch v Vickers.[602] As such US target shareholders are able to bring a personal claim for a breach of this duty.[603] As noted above, the pivotal case in the development of this duty was Smith v Van Gorkom.[604] Discussion of which has already highlighted the content of the duty. The point of importance now is that, in this case, the court restated the principle in Lynch v Vickers that the board had breached a duty it owed directly to its shareholders.[605] Shareholders, therefore, could

[599] ss. 177, 182 CA
[600] See ss180, 239 CA (however if the transaction is substantial it will require shareholder approval under s.190
[601] This state fiduciary duty to disclose was only created in the last three decades); see Strine et al (2009) (n)
[602] (n573)
[603] ibid (The court held that corporate directors owe to their stockholders a fiduciary duty to disclose all facts germane to the transaction at issue in an atmosphere of complete candor); see also Smith v Van Gorkom (n375) (where the court established that a fiduciary duty of disclosure is owed to the shareholders by the directors).
[604] (n375)
[605] See chapter five section 4.3.2



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themselves initiate proceedings against the directors for such breaches of duty owed to them personally; the action did not have to be brought by the company itself.

By comparison, in the UK it is trite law that directors owe their fiduciary duties to the company itself, not directly to shareholders. This has been long established in common law,[606] and was repeated in the statutory codification of these duties.[607] UK shareholders are also not owed a separate and direct fiduciary duty of loyalty by the directors under common law. This principle was reaffirmed by Sharp v Blank.[608] In this case target shareholders alleged that their directors had breached a (non-directorial) common law fiduciary duty of loyalty that was owed to them directly, to provide sufficient information when approving a transaction. The court however ruled that the relationship between the director and shareholder did not give rise to a common law fiduciary duty of loyalty.[609] The court instead directed the shareholders to use the directors' duty route as laid down in the CA. The court held that the relationship between a director and their shareholders is only one of giving advice and information for a particular purpose:

*'there is nothing here which as far as I can see comes close to a relationship where the directors have in any more extended sense undertaken to act for or on behalf of the shareholders in such a way as to give rise to a duty of loyalty, or have undertaken an obligation to put the interests of shareholders first, or are themselves entering into transactions with the shareholders, or where there are any of the other hallmarks of a fiduciary relationship.'*[610]

The director 'does not have, by virtue of his appointment as director, any direct relationship with the shareholders.'[611] Even though the interests of the shareholders and the company are generally aligned it does not mean that 'a director has agreed to act for the individual shareholders or has a direct relationship with them – his relationship is with the company.'[612]

[606] Percival v Wright [1902] 2 Ch 401
[607] See s170(1) CA
[608] Sharp v Blank (n281)
[609] The court also noted that the duty to provide sufficient information did not have the same characteristics as a legal fiduciary duty; see ibid [21-23]
[610] ibid [15]
[611] ibid [13]
[612] ibid



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The courts have noted that the only time in which a director may owe a direct duty to a shareholder is if a "special relationship" can be established.[613] That special relationship however has to be 'something over and above the usual relationship that any director of a company had with its shareholders.'[614] The court reiterated in Sharp v Blank the cases where a fiduciary duty has been held to exist:

*'[These] mostly concerned companies which were small and closely held, where there was often a family or other personal relationship between the parties, and where, in almost all cases, there was a particular transaction involved in which directors were dealing with the shareholders, from which the directors often stood to benefit personally…[and where a director] might be tempted to exploit that relationship to take unfair advantage of the shareholders for their own benefit.*[615]*'*

This particular judgment concluded that not only do directors not owe statutory duties to the shareholders, as laid out in s.171 to 177, but that individual shareholders do not have a private right of action alleging a breach of a general fiduciary duty under tort, unless that special relationship could be shown.[616]

That concludes the relevant general duties found in the CA, however, for completeness it should also be noted that in certain circumstances, UK target shareholders may allege that a director has breached s.90 of FSMA, if the directors have failed to disclose information on listing documents. If successful they can receive compensation for such a breach.[617] Does s.90 give shareholders a personal right to bring proceedings against directors and is this sufficient to bridge the gap (in terms of shareholders' ability to sue target directors) between the UK and the US? It is argued that it does not.

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[613] Sharp v Blank (n281) [10]; see also Allen v Hyatt (1914) 30 TLR 444 (decision of the Privy Council in a Canadian appeal, where it was held that directors who had acquired shares from shareholders in order to sell them to a third party had made themselves agents for the shareholders, and hence were accountable for the profits they had made.); Coleman v Myers [1977] 2 NZLR 225 (a decision of the Court of Appeal of New Zealand, where the company was an old established private company in which many of the shareholders, individually or through trusts, were relatives, and two directors (father and son) engineered a takeover, persuading some members of the family to sell, and seeking to compel a reluctant minority.)

[614] Sharp v Blank (n281)

[615] ibid

[616] A shareholder however may bring a class action in the UK alleging a breach of s.90 FSMA

[617] s.90A FSMA requires compensation to be paid when a loss is made on listed securities due to untrue or misleading statements or omissions in particulars.



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Certainly, s.90 does *close* the gap a little. However, only a very small number of cases have been commenced alleging a breach of this legislation.[618] As such, complaints of a breach of s.90 FSMA are largely new and untested before the courts.[619] The lack of precedents in such actions therefore require "lawyers to grapple with novel and, often, complex issues in order to recover investors' losses."[620] These issues include:

> *'prevailing industry practice, the knowledge of the issuer and relevant individuals at the time the listing particulars or prospectus was prepared and, perhaps most crucially in relation to claims arising out of the financial crisis, the foreseeability of future events or circumstances.'*[621]

The development of a successful case for the target shareholders is also severely limited by access to information; this is because limited public information may only be available for these companies.[622] Consequently whilst there are a number of UK statutory disclosure obligations placed upon directors they are limited in scope when compared to the US state law obligations.[623]

### 7.3 Differences in the "Forms of Action"

The second explanatory candidate for the TSvTD spike concerns differences in the "forms of action" available to US and UK shareholders. As noted in section 4.3 a "form of action" is not the same as a "cause of action." A form of action refers to the form of legal proceedings that must be used to advance some cause of action. It is the distinction between the substance

[618] See Hall v Cable and Wireless plc [2009] EWHC 1793 (Comm) (where the claimants failed to properly establish a loss); Tesco shareholders have also commenced a claim alleging a breach of s.90 (The investors allege that they suffered £150m in losses because of accounting irregularities) see Bentham Europe, Shareholder Action Against Tesco PLC <http://www.benthameurope.com/en/tesco-plc-overview> accessed 12 Nov 2016; See also Jenny Anderson, 'Tesco Chairman to Step Down as Overstatement of Profit Grows' *The New York Times* (23 Oct, 2014) <https://www.nytimes.com/2014/10/24/business/international/tesco-plc-chairman-richard-broadbent-profits.html?_r=0> accessed 29 December 2016; Shareholders of RBS have also commenced a claim alleging a breach of s.90 FSMA (They claim that the Rights Issue Prospectus which was circulated by their directors prior to their 2008 crash was misleading as it contained untrue and misleading statements, and also omitted to disclose material information that should have been known to RBS at the time of the Prospectus) see Stewarts Law LLP, The Proceedings So Far <http://www.stewartslaw.com/the-proceedings-so-far.aspx> accessed 12 November 2016

[619] See Sean Upson, The rising trend in shareholder litigation (28 May 2015) <http://www.bcllegal.com/the-brief/opinion/sean-upson-partner-of-stewarts-law-outlines-the-rising-trend-in-shareholder-litigation#sthash.KnTsla6X.dpuf> accessed 14 November 2016

[620] ibid

[621] ibid

[622] ibid

[623] See Lynch v Vickers (n573); see also Smith v Van Gorkom (n375)



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of a claim (the complaint) and the procedural form in which a claim is brought. For example, a target shareholder may complain that a director has breached their fiduciary duty to disclose under s.175, which is the *cause* of action. One *form* of action for pursuing such a claim might be a derivative claim brought by one or more shareholders.

How might differences in the forms of action available in the UK and the US be relevant to this analysis? The argument made in section 7.2 is that the substantive obligations owed by directors, in the UK, are owed ordinarily only to the company, not directly to shareholders. Aside from s.90 FSMA, shareholders generally cannot themselves bring a "personal" action for breach of such duties. In the US, they generally can do so. Still, this immediately seems to prompt three further questions: First, in respect of the UK, even if actions for breach of duty must be brought by the company itself, why do we not see just as many actions being brought by (or on behalf of) the company as we see being brought personally by shareholders in the US? Second, in respect of the US, just why are shareholders so ready and willing to bring personal proceedings? Third, (and back to the UK), even where personal actions are possible (under s.90 of FSMA) why do we still see so few UK actions being brought? The answers to these questions lie at least partly in the differences in the *forms of action* available within the two jurisdictions.

### 7.3.1 Derivative Claims

Why are so few actions brought by target companies in the UK to enforce breaches of duty owed by target directors? Why is there not a "UK" litigation spike, of actions brought by target companies against target directors (a TCvTD spike), comparable to the TSvTD spike in the US? To answer these questions, it must be highlighted again that proceedings *by the company* must, ordinarily, be authorised by that organ within the company enjoying the authority to decide that the company shall sue. It is a "constitutional question," for each company, which organ has such authority; it depends on how the constitution of that company allocates decision-making power.[624] For most companies, including those with 'Model Articles,' their constitutions allocate such power to the board.[625] Thus, an action by

[624] Breckland Group Holdings Ltd v London & Suffolk Properties Ltd [1989] BCLC 100
[625] See The Companies (Model Articles) Regulations 2008 (SI 2008/3229) sch 3 part 2



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the company against some of its own directors requires the board of that company to authorise such proceedings. For many obvious and often-discussed reasons, it is highly unlikely the board will do any such thing. The UK (like most jurisdictions) however does have a form of action, the "derivative claim" that is intended precisely to overcome this predictable reluctance of the board to authorise proceedings by the company. Why then do we not find as many derivative claims by UK target shareholders as we see personal actions by US shareholders? What is lacking with derivative claims?

A derivative claim is a claim brought by one or more shareholders, but "on behalf of the company." It is used to enforce breaches of directors' duty owed to the company. If the director is found liable, the remedy against them will be awarded to the company, not to the shareholder bringing the claim. The rules governing this form of action in the UK were, until 2006, common law rules. However, the Companies Act 2006 chose, for almost all derivative claims,[626] to replace these common law rules with a new "statutory derivative claim." The intention, in introducing the statutory derivative claim in the UK, was two-fold. First, it aimed to make the law itself clearer and more accessible. Second, it aimed to make it easier to bring, or at least, to commence derivative claims. This was achieved by clearly abandoning one, and probably abandoning another, common law requirements that a claimant previously had to satisfy.

The first requirement, clearly abandoned in the new statutory rules, was that derivative actions[627] at common law could only be brought in respect of *"fraudulent"* breaches of duty. As s.260(3) makes clear, a derivative claim can be brought for *any* breach of duty, whether or not it satisfies the (very unclear) common law definition of fraud. This relaxation of the new statutory derivative claim has some significance for this argument. The wrongdoing alleged against directors might well consist of allegations of *negligence*; for example, that the target directors failed to value accurately, either the target company itself, or the bidder's offer. At common law, however, directorial negligence provided it did not benefit the negligent director, did not constitute fraud, and could not be sued for derivatively. Now,

[626] "Multiple derivative claims" are not covered by the statutory action, and must still be brought under the common law rules: see Bhullar v Bhullar [2015] EWHC 1943 (Ch)
[627] Whereas the new statutory proceedings are called "derivative *claims*," their common law predecessors were known as "derivative *actions*."



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under CA, such directorial negligence, like any other breach of duty, can be the basis of a derivative claim.

The other common law requirement that has (probably[628]) been abandoned is that the claimant shareholder previously had to show that the "wrongdoers are in control" of the company. Again, if this requirement has indeed been abandoned, this also has some significance for this argument. The "wrongdoer control" requirement rendered derivative claims almost impossible in widely held companies (which most target companies would likely be). Directors of these companies typically have always been likely to own only a small fraction of the shares, and therefore do not enjoy control, at least insofar as "control" means "legal" control.[629] Thus, the new statutory derivative claim sought to make it easier for claimants to at least to start derivative proceedings, and achieved this in ways which are directly relevant to, and helpful for, shareholders alleging directorial negligence in widely held companies, the very scenario that might face target shareholders in a takeover situation. However, in reforming the derivative claim, Parliament was also concerned to ensure that only meritorious claims would be allowed to continue and disrupt companies and their directors. Alongside the relaxations already described, then, the CA also introduced a clearer procedure under which the courts now effectively act as a "gatekeeper," by blocking those claims which ought not to be allowed to run to trial. Here those legal obstacles begin to be confronted, in part actually strengthened by the 2006 Act, which greatly suppresses the number of derivative claims which are, or are ever likely to be, brought in the UK.

In order to proceed with a derivative claim, the claimant shareholder(s) must, immediately upon commencing the claim, apply to the court for permission to continue it.[630] This application process has two stages.[631] Firstly, the shareholders will submit evidence to the court to be considered in a paper hearing.[632] It is the responsibility of the shareholders to

[628] This is based on the fact that CA makes no explicit reference to the claimant's need to establish wrongdoer control. However, for an argument that this requirement persists see David Kershaw 'The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle' (2015) 3 Journal of Business Law 274

[629] In Prudential Assurance Co Ltd v Newman Industries Ltd [1982] Ch 204 (the court of appeal suggested control might mean something closer to "de facto" control, but this was neither defined with clarity, nor did it seem to offer much of a relaxation on the test that the claimant shareholder had to satisfy).

[630] Civil Procedure Rules ("CPR") 19.9 – 19.F; see also Practice Direction 19C

[631] See Dignam, Lowry (n153) 202

[632] S.261 CA



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establish that they have a prima facie case for permission to continue the claim.[633] If they cannot establish this then the court will dismiss the application.[634] If the court does not dismiss the application then, and secondly, a full permission hearing takes place.[635] The factors that the court must consider when granting or refusing permission at this hearing are set out in ss.263(2) and (3) of CA. We might begin by noting that the total, combined, effect of these various factors is to weigh the court's decision against granting permission. This is especially evident in relation to those factors found in s.263(2), which operate as 'mandatory bars'. In other words, if any one of the three factors identified in s.263(2) exists, then the court has no discretion, and must refuse permission to continue the claim. Those factors are

*'. . . (a)that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim, or (b)where the cause of action arises from an act or omission that is yet to occur, that the act or omission has been authorised by the company, or (c)where the cause of action arises from an act or omission that has already occurred, that the act or omission— (i)was authorised by the company before it occurred, or (ii)has been ratified by the company since it occurred.'*[636]

Moreover, even if the shareholder 'survives' these mandatory bars to the granting of permission, the court must then (but only then) apply the list of discretionary factors found in s263(3). But again, this long list of factors tends to weigh heavily on claimant shareholders, giving the court a number of different avenues for refusing permission. These discretionary factors are:

*'(a)whether the member is acting in good faith in seeking to continue the claim; (b)the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it; (c)where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—(i)authorised by the company before it occurs, or*

[633] s.261(2) CA (this requires the shareholders to demonstrate that they have a good cause of action and that the cause of action arises out of a directors breach of duty); see Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch)
[634] ibid; if the application is dismissed the shareholders may request an oral hearing under CPR 19.9A (10); See also David Milman, 'Shareholder litigation in the UK: the implications of recent authorities and other developments' (2013) 2013 Company Law Newsletter 342
[635] Dignam, Lowry (n153) 202
[636] S.263(2) CA



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*(ii)ratified by the company after it occurs; (d)where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company; (e)whether the company has decided not to pursue the claim; (f)whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.'*

The court must also have particular regard to any evidence before it as to the views of the members of the company who have no personal interest, direct or indirect, in the matter.[637] In addition to these provisions, the court in Stimpson v Southern Landlords Association[638] noted that the list of factors to be considered in deciding whether to grant an application under s.263(3) were not "exhaustive,"[639] and it was therefore open for the courts to take other factors in to account, such as the applicant's motive.[640]

In summary, the court has vast judicial discretion when deciding whether to grant permission to continue a derivative claim.[641] As a consequence, in a majority of cases brought since the introduction of the statutory claim procedure, permission to continue the claim has been refused. Dignam and Lowry note that these procedural requirements 'represent significant hurdles to be overcome' by any claimant, and that the case law in this area demonstrates that the courts have a "cautious approach" when deciding how to exercise their discretion.[642] There was a clear policy, during the introduction of s.260, that derivative claims should be 'exceptional,'[643] and that they should be subject to 'tight judicial control at all stages.'[644] This is certainly the case, and Reisberg notes that this is illustrative of how procedurally and substantively English law has developed to provide disincentives to prospective claimants.[645]

[637] s.263(4) CA; see also Smith v Croft (No 2) [1988] Ch 114 (in allowing a derivative claim to continue the court will have regard to the majority of the minority's views)
[638] [2009] EWHC 2072 (Ch)
[639] ibid at 37
[640] ibid at 44
[641] See Arad Reisberg, 'Derivative Claims under the Companies Act 2006: Much Ado About Nothing?' In J Armour, J Payne (eds), *Rationality in Company Law: Essays in Honour of D D Prentice* (Hart Publishing, 2008)
[642] Dignam, Lowry (n153) 205; see also Keay AR, Loughrey JM, 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) The Law Quarterly Review 469; Loughrey JM, Keay A, 'An assessment of the present state of statutory derivative proceedings' in Loughrey J (eds) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar Publishing, 2012), 187
[643] Hansard HL Vol 679 (Official Report) (27 February 2006) Cols GC4-5 (Lord Goldsmith).
[644] ibid
[645] See Reisberg (n641)



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As described by Reisberg, 'imagine a bona fide shareholder who genuinely contemplates taking an action and reads through this (non-exhaustive, it should be stressed) list; faced with these complexities, the average shareholder will often give up in despair at this early stage.'[646]

Moreover, and in addition to the many legal/procedural hurdles considered so far, there are also many other, perhaps more 'practical' or 'commercial', obstacles preventing or discouraging shareholders from bringing a derivative claim. In the first instance it will be difficult for shareholders even to detect any wrong done by a director. Shareholders, particularly in large public companies will have limited access to information. An additional deterrent against any speculative claims is the one of costs. Although the court can order the company to indemnify the shareholder,[647] some recent cases suggest a growing reluctance to make such an order, even where permission to continue the claim is being given.[648] The practicalities of financing shareholder litigation will therefore remain a major obstacle. Reisberg summarises the position as follows: '[t]here is nothing in the new procedure that will convince a rational shareholder they should be better off litigating the case on behalf of the company rather than selling their shares.'[649] There is also a risk that the company will ratify the director's decision and destroy the derivative claim (as long as the breach is one which is capable of being ratified and the ratification is not void under s.239).[650] The target shareholder must therefore out manoeuvre significant obstacles in order to bring a derivative claim.

This section began by asking why there is not a huge spike of UK litigation, albeit in the form of derivative claims, which might equate to the spike of personal actions brought by shareholders in the US. The answer to that is now clear. The continuing difficulty in commencing derivative claims in the UK severely limits the number of claims target shareholders can, or would ever be willing to, pursue.

[646] Reisberg (n641)
[647] CPR 19.9E
[648] An initial foretaste of this judicial queasiness about giving indemnity orders is seen in Smith v Croft (No 3) [1987] BCLC 355; more recently, see Bhullar v Bhullar (n626)
[649] Reisberg (n641)
[650] s.239 CA



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7.3.2 Class Actions

Having addressed the reluctance of UK shareholders to sue, this section now turns to the next question we asked ourselves in the introduction to 7.3: why are US shareholders so much more ready to litigate? The first point to make clear is that the reason does *not* lie in the superiority of US derivative proceedings, in comparison to the UK version. The process of bringing a derivative claim in the US is in many respects just as difficult as it is in the UK. For instance, US State legislatures and courts have also added additional hurdles for claimants to overcome, including requirements that they make a demand on the board of directors before filing suit, and permitting the use of special independent litigation committees of boards of directors to decide if derivative suits should be terminated.[651] But, as we have established already, US target shareholders do not *need* to rely on, the almost equally flawed, US derivative claims because shareholders can bring personal actions in respect of the directors' failure to meet their disclosure obligations. This is important to make clear, but it really just repeats the point already established in section 7.2 and still does not completely explain the question of the readiness of US target shareholders to bring personal actions.

The answer lies in the very favourable US rules that constitute the next key "form of action" which this section addresses, namely the "class action." It is the class action which provides the reservoir feeding the flow of US takeover litigation. This is especially so when understood in the context of the rules governing attorneys' fees, to which we shall return to in section 7.3.2.1. In a study completed by Krishnan et al it was found that 87 percent of the takeover litigation they recorded were shareholder class actions[652] and only 3.5 percent were derivative suits.[653] Shareholders in the US prefer to bring takeover litigation as a class action because they can avoid the additional procedural barriers that are raised in derivative claims.[654] As noted above, recent empirical studies show that the majority of US takeover litigation is brought by the shareholders via class action lawsuits.[655] A class action lawsuit is a procedural device that permits one or more plaintiffs to file and prosecute a lawsuit on

[651] Thompson, Thomas 'The New Look of Shareholder Litigation: Acquisition- Oriented Class Actions' (2004) 57 Vanderbilt Law Review 133 at 139; see also George W Dent, 'The Power of Directors To Terminate Shareholder Litigation: The Death of Derivative Suits' (1980) 75 Northwestern University Law Review 96
[652] Krishnan et al (2012) 1252
[653] ibid
[654] See Thompson, Thomas (n651)
[655] See Krishnan et al (n514); Daines, Koumrian (n526); Thompson and Thomas (n651)



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behalf of a larger group, or “class.” The subject matter of these lawsuits can vary widely. The “usual rule”[656] however requires that the issue in dispute is common to all members of the class and that the persons affected are so numerous that it would be impractical to bring them all before the court.[657] To understand the impact of this form of action, however, we must have regard not only to its availability, but also to the large fees that are paid to shareholders' lawyers under this system.

Under the US system, ‘a lawyer with an eye for an opportunity can easily mastermind a class-action suit.’[658] Ramseyer and Rasmusen state that this can be done by completing a few steps: firstly the lawyer must identify a legal wrong (in the case of a takeover, breach of the target directors fiduciary duty); and then locate several of the victims (target shareholders) suggesting that they can retain them to sue on their behalf, and all others similarly situated.[659] Agency problems also often arise, ‘as clients are usually too scattered to control the lawsuit directly, so they happily or unknowingly delegate authority to the lawyer, and as an incentive for this task they [the lawyers] will collect compensation.’[660]

7.3.2.1 Attorney Fees in Shareholder Class Actions

As was established in chapter six, the vast majority of shareholder litigation is settled between the parties before they reach trial. Attorneys that bring these lawsuits are usually compensated for their efforts with a court-awarded fee.[661] Despite the claims only reaching settlement a US lawyer can be “handsomely rewarded” for encouraging target shareholders to bring a class action.[662] Fisch et al argue that this practice only benefits the lawyers who bring the claims and not the shareholders they represent.[663] Due to the representative nature of this type of litigation a settlement agreement requires court approval, and as such they approve

[656] Califano v Yamasaki 442 US 682 (1979) 700-701
[657] West v Randall 29 F Cas 718 721 (No 17 424) (C C D R I 1820); see also Ramseyer JM, Rasmusen EB, ‘Comparative Litigation Rates’ (2010) Harvard Law School Discussion Paper No 681, 26 (they noted that ‘the drafters of the modern class action in the US designed this form of action as a mechanism that would let victims cost effectively prosecute claims for wrongs that impose large losses on the community as a whole, but only trivial damages on any one victim.’)
[658] Ramseyer, Rasmusen (n657) 26
[659] ibid 27
[660] ibid 26
[661] Fisch et al (n563) 557
[662] Miller (n463) 76
[663] Fisch et al (n563) 557



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the agreed attorney costs.[664] Consequently, even though the majority of these claims never reach trial, litigation is generated because the court is still required to play a role in the conclusion of the claims.

The court's role at a settlement hearing is threefold: the court must approve the certification of the class;[665] the court must assess whether the settlement is fair and reasonable;[666] and the court must decide on the amount of the fee to be awarded to plaintiffs' counsel.[667] Fisch et al note that:

> *'while these steps are independent in theory, as a practical matter, they often collapse; if the court determines that the benefits provided by a settlement are illusory, the plaintiff class will not have received any consideration for the releases that accompany a settlement, and the settlement will not be seen as fair.'*[668]

Only then, may the court properly refuse to approve the settlement.[669] The decision of the court to rule that there is no benefit, however, may 'raise questions about the adequacy with which the class has been represented, suggesting that the court should deny class certification.'[670] Similarly, if the court approves the settlement, it has 'implicitly concluded that the plaintiff class has received something of value, making it difficult to decline to award a fee to class counsel.'[671]

Once the court has approved the settlement, it must independently consider the fee award. This is because '[a] litigant who confers a common . . . benefit upon an ascertainable stockholder class is entitled to an award of counsel fees and expenses for its efforts in creating the benefit.'[672] The court's determination of what constitutes a reasonable fee is

[664] Fisch et al (n563) 568; see also Federal Rules of Civil Procedure 23(e) (which requires judicial approval for dismissal or compromise of a class action)
[665] Amchem Prods Inc v Windsor 521 US 591 618–20 (1997)
[666] In re Triarc Cos 791 A2d 872 876 (Delaware Chancery 2001)
[667] In re Sauer–Danfoss Inc Shareholders Litigation 65 A3d 1116,1135 (Delaware Chancery 2011)
[668] Fisch et al (n563) 568
[669] ibid
[670] Transcript of Teleconference at 10–11, In re Transatlantic Holdings Inc Shareholders Litigation No 6574-CS (Delaware Chancery Mar 8, 2013)
[671] Fisch et al (n563) 568
[672] United Vanguard Fund Inc v Takecare Inc 693 A2d 1076 1079 (Delaware 1997)



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based on consideration of the Sugarland[673] factors: (i) the amount of time and effort applied to the case by counsel for the plaintiffs; (ii) the relative complexities of the litigation; (iii) the standing and ability of petitioning counsel; (iv) the contingent nature of the litigation; (v) the stage at which the litigation ended; (vi) whether the plaintiff can rightly receive all the credit for the benefit conferred or only a portion thereof; and (vii) the size of the benefit conferred.[674] 'Among these factors, the last two receive the greatest weight.'[675]

The average fee awards for the settlement of takeover litigation vary widely.[676] In *Del Monte*, plaintiffs' counsel received one of the largest fee awards, which was $22.3 million for a case that generated a recovery to the plaintiff of $89.4 million;[677] at the "lower end" of the scale $100,000 was the award to the lawyers in Gen-Probe for a disclosure only settlement (whereby only additional disclosures are released by the target directors to their shareholders).[678] Cain and Davidoff Solomon's study shows that the average fee awarded in disclosure only settlements was approximately $500,000 in 2014 and $362,000 in 2015.[679] These figures are high considering it may take little effort for the attorneys to request additional disclosures and confer only a small benefit to shareholders, considering that these disclosures do not usually have an effect on the shareholder vote.

The way in which the court must assess fees has however dragged state court judges into the 'task of indirectly promulgating disclosure standards in connection with the approval of fee awards.'[680] If disclosure claims were dealt with only by federal courts, as proposed by Fisch et al, this could lead to a reduction in US takeover litigation overall. This is because the 'inability to win fees for disclosure settlements would reduce the profitability of takeover

[673] Sugarland Indus Inc v Thomas 420 A2d 142 (Delaware 1980)
[674] ibid; see also In re Plains Res Inc Shareholders Litigation No Civ A 071-N 2005 WL 332811 [3] (Delaware Chancery Feb 4 2005) (citing Sugarland (n673) [149–50]).
[675] In re Celera Corp Shareholder Litigation No 6304–VCP 2012 WL 1020471 at 30 (Delaware Chancery March 23 2012); accord In re Anderson Clayton Shareholders' Litigation no 8387 1988 WL 97480 [3] (Delaware Chancery Sept 19 1988)
[676] Fisch et al (n563) 567
[677] Transcript of Settlement Hearing at 57–58, Del Monte Foods, 25 A3d 813 (2011) (No 6027– VCL)
[678] In re Gen-Probe Inc Shareholders Litigation No 7495-VCL 2013 WL 1465619 at 9 (Delaware Chancery Apr 10 2013).
[679] Cain, Davidoff Solomon (n517) 5
[680] Fisch et al (n563) 557



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litigation for plaintiffs' firms on a portfolio basis, creating an incentive to curtail claims.'[681] The judges in the Delaware Chancery Court are very conscious of the incentives that these attorney fee award decisions can create.[682] In Re Gen Probe, Vice Chancellor Travis Laster criticised the growth, and benefits, of this particular litigation.[683] He stated that the court was now "giving out, left and right, five hundred grand for" weak claims which conferred "very weak" benefits to shareholders.[684] He additionally noted that the court may now need to recalibrate the system of assessing attorney's fees in light of the proclivity for disclosure only settlements.[685] In Re Aruba Networks, in 2015, Vice Chancellor Travis Laster again stated that this dynamic represented a "systemic" problem that has resulted in a "misshapen legal system."[686] In this hearing he rejected the proposed disclosure-only settlement that had been filed objecting to Hewlett-Packard's $2.7 billion acquisition of Aruba Networks.[687]

These recent decisions make it clear that the Delaware courts are drawing a line in the sand. The historical practice of approving disclosure only settlements that provide little value to the shareholders in exchange for a release which is "overly broad" and payment of excessive plaintiffs' attorneys' fees will be no longer be followed.[688] In Re Trulia the court stated that 'litigants [who] continue to pursue disclosure settlements…can expect that the Court will be increasingly vigilant in scrutinizing the "give" and the "get" of such settlements to ensure that they are genuinely fair and reasonable to the absent class members.'[689] This stricter approach taken by the Delaware courts, and crack down on the amount of fee awards given, may have already had an effect on the levels of litigation in the US.

[681] Fisch et al (n563)
[682] See Sauer–Danfoss (n667); see also In re Paetec Holding Corp Shareholders Litigation C A No 6771-VCG (Delaware Chancery March 19 2013); In Re Gen-Probe inc (n678); In re Riverbed Technology Inc Stockholders Litigation CA No 10484-VCG (September 17 2015); In Re Trulia inc Stockholder Litigation CA No 10020-CB (Delaware Chancery Jan 22 2016); Davidoff Solomon (2014) (n542)
[683] In Re Gen-Probe inc. (n678)
[684] ibid [47]
[685] ibid [48]
[686] In re Aruba Networks Inc Shareholder Litigation No 10765-VCL (Delaware Chancery Oct 9 2015)
[687] ibid
[688] In Re Trulia (n682)
[689] ibid



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**Figure 7.2**

| | Deals | Litigation | % with litigation |
|---|---|---|---|
| 2005 | 183 | 72 | 39.3% |
| 2006 | 232 | 99 | 42.7% |
| 2007 | 249 | 97 | 39.0% |
| 2008 | 104 | 50 | 48.1% |
| 2009 | 73 | 62 | 84.9% |
| 2010 | 150 | 131 | 87.3% |
| 2011 | 128 | 117 | 91.4% |
| 2012 | 122 | 112 | 91.8% |
| 2013 | 118 | 110 | 93.2% |
| 2014 | 137 | 130 | 94.9% |
| 2015 | 73 | 64 | 87.7% |
| Total | 1,569 | 1,044 | 66.5% |

*Cain and Davidoff Solomon (2015) See Table A

Cain and Davidoff Solomon recorded that there has been a sharp and significant decline in litigation.[690] The figures in the table above, taken from their report, show that takeover litigation for completed transactions declined in 2015 with only 87.7 percent experiencing litigation. Whilst these figures still remain at a high rate, those transactions which experience litigation have fallen from the 94.9 percent rate that was recorded in the previous year. Cain and Davidoff Solomon believe this may correlate with the Delaware courts challenge of "disclosure-only" settlements which began in the autumn of 2015.[691] They found that in the wake of these decisions the rates of filings for completed and uncompleted transactions fell to 21.4 percent and a number of settlements were withdrawn.[692]

While disclosure only settlements have not been "eliminated by these recent decisions," the landscape has been "materially changed."[693] It seems increasingly certain that any shareholder lawsuit (and resulting settlement with a universal release) will need to be predicated on true substance that solves a material deal deficiency.[694] Conversely, it seems uncertain whether the 'heightened standard for a settlement will simply deter plaintiff firms

[690] Cain, Davidoff Solomon (n517)
[691] ibid 3
[692] ibid
[693] DLA Piper Insights, Delaware's one-two punch to M&A litigation disrupts the cozy status quo of M&A deal settlements (7 Oct 2015) <https://www.dlapiper.com/en/uk/insights/publications/2015/10/delaware-one-two-punch/> accessed 5 June 2016
[694] ibid



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from filing suits in the first place.'[695] This litigation is not about disclosure,[696] but what fee award the attorney may get for commencing the claim. The encouragement of legal advisers to commence litigation and the ease in which the class action can be brought significantly contribute to the TSvTD spike.

### 7.3.3 UK Group Litigation Orders and Representative Actions

This section now, finally, addresses the third question that was posed regarding the contribution of the 'forms of action' in explaining the different litigation landscapes. The shortcomings of UK derivative claims may help to explain the absence of a derivative claim spike in the UK. The ease of bringing class actions in the US (especially when fuelled by generous fee awards) may help to explain the prevalence of US litigation. But why is there no UK spike of class actions?

This can partly be explained by repeating the explanation given in section 7.2, that the general duties of directors are not owed directly to shareholders. They, the shareholders, can therefore not bring personal actions in respect of such breaches, either individually or collectively as a class action. But now, it can be noted that there are some obligations by directors that do indeed give a personal right to shareholders to sue: s.90 FSMA creates such a right. Why, then, is there not a spike of litigation enforcing that right in the UK? Again, the answer is to be found in comparing forms of action in the two jurisdictions.

The comparison goes beyond the rather obvious point that, technically, US style class actions are simply not available in the UK. For whilst it is true that the UK does not have a form of collective action labelled as a "class action," designed with all the features of the US form which bears that name, the UK does have two forms of collective action. These are, first, the Group Litigation Order ("GLO") and, second, the representative action, and both can, like the US class action, be used as a form of action to advance claims collectively.

[695] DLA Piper Insights (n693)
[696] Private Securities Litigation Reform Act of 1995, Public Law No 104-67 109 Stat 737



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GLO's were officially introduced in to the English Civil Procedural Rules ("CPR") in 1999.[697] A GLO is an order made under rule 19 of the CPR, to provide for the case management of claims which 'give rise to common or related issues of fact or law.'[698] A GLO must contain directions about the establishment of a register (the "group register") on which the claims managed under the GLO will be entered; specify the GLO issues which will identify the claims to be managed as a group under the GLO; and specify the court (the "management court") which will manage the claims on the group register.[699] Shareholders wishing to join group litigation must "opt in" by applying to be entered onto a group register before a date that is specified by the court.[700] A GLO will not be permitted if 'the court considers it more appropriate that the claims are consolidated or for there to be a representative action.'[701]

Representative actions, on the other hand, may be made by (or against) one or more persons who have the "same interest" in a claim.[702] The "same interest" requirement is however quite restrictive. In the Court of Appeal judgment in Emerald Supplies Ltd v British Airways Plc the court stated that the claimants must have 'the same interest in the claim as the claimant at the time the claim was begun' and cannot only be defined by a future end-result.[703] This case has been cited by some commentators as an example of the shortcomings of the collective actions mechanisms currently available in England and Wales and they are not often used.[704]

In the UK the 'take-up of GLOs has been modest,' this is in stark contrast to the frequent use of the class action system in the US.[705] Many commentators attribute the failure of the GLO

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[697] Ashurst 'Collective Actions: UK Guide' (2016) 1
[698] CPR 19
[699] ibid
[700] CPR 19
[701] ibid 19B
[702] ibid 19.6
[703] [2010] EWCA Civ 1284 at 346-347
[704] See Ashurst (n697) 2; see also Rachael Mulheron, 'Opting in, Opting out, and Closing the Class: Some Dilemmas for England's Class Action Lawmakers' (2011) 50 Canadian Business Law Journal 376; Rachael Mulheron, 'Emerald Supplies Ltd. v. British Airways plc: A Century Later, the Ghost of Market Lives On' (2009) 8 Comparative Law Journal 159; A Owens, 'A Collective Debate' (2009) 159 New Law Journal 956; J Knibbe, 'Case Comment: Emerald Supplies Ltd. v. British Airways Plc (2010) 31 European Comparative Law Review 139
[705] Ashurst (n697) 1



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to a lack of an "opt-out" system.[706] The opt-out element is critical to the US operation of the class action; claimants may, 'without taking any active steps in the proceedings, participate in the proceeds of any court judgment or court-sanctioned settlement, unless they specifically opt-out.'[707] The difficulty in commencing collective actions in the UK provoked calls to the Civil Justice Council ("CJC") to enact a more effective system of these types of actions.[708]

In 2008, the CJC completed a report attempting to address the failure of collective actions in the UK.[709] The report concluded that the current system was indeed insufficient to provide effective access to justice. The UK Government in 2009 responded however by stating that rather than adopting a US style class action, which they stated would be inappropriate, collective actions would best be taken forward on a sector by sector basis.[710] They concluded that the adoption of an opt-out system would go against UK tradition and EU recommendations.[711] Even where an opt-out collective action has been made available in certain sectors since 2009 they are very rarely used. For instance, in 2014 it was confirmed that an "opt-out" collective redress mechanism for victims of competition law infringements would be introduced by the Consumer Rights Bill. Since the changes to the law were made in October 2015, only one collective action has been commenced.[712] Whilst the changes have not opened any floodgates of litigation to date, only time will tell if this new system will become more popular.

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[706] Ashurst (n697) 1
[707] Jonathan Cary, Jo Rickard, 'Section 90 of FSMA Time for collective action?' (August 2012) <http://www.shearman.com/~/media/Files/NewsInsights/Publications/2012/08/Section-90-of-FSMA/Files/View-full-iPLC-Magazinei-article-Section-90-of-F__/FileAttachment/Section90ofFSMALT082112.pdf> accessed 21 November 2016
[708] See Ashurst (n697)
[709] Civil Justice Council, 'Improving Access to Justice through Collective Actions' Developing a More Efficient and Effective Procedure for Collective Actions, Final Report (2008) <https://www.ucl.ac.uk/laws/judicial-institute/files/Improving_Access_to_Justice_through_Collective_Actions_-_final_report.pdf > accessed 21 November 2016
[710] Alexander Horne, Tim Edmonds, Collective or Class Actions (2009) <http://researchbriefings.files.parliament.uk/documents/SN05240/SN05240.pdf> accessed 21 November 2016
[711] Ashurst, Collective Actions Update: "opt-out" coming to a competition claim near you (2014) <https://www.ashurst.com/en/news-and-insights/legal-updates/collective-actions-update-opt-out-coming-to-a-competition-claim-near-you/> accessed 10 November 2016; see also Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013H0396> accessed 10 November 2016
[712]Court of Appeal Tribunal, Dorothy Gibson v Pride Mobility Products Limited <http://www.catribunal.org.uk/237-9255/1257-7-7-16-Dorothy-Gibson.html> accessed 10 November 16; see also Pinset Masons, First opt-out collective action lodged with Competition Appeal Tribunal (Jun 2016) <http://www.out-law.com/en/articles/2016/june/first-opt-out-collective-action-lodged-with-competition-appeal-tribunal/> accessed 10 November 2016



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Collective actions in the UK are, more importantly, unlikely to be a viable option due to a lack of incentives for those bringing the claims.[713] This is largely due a need to rely on third party funders, who play a pivotal role in paying for the costs of litigation, with lawyers working on conditional fee no-win, no (or low) fee arrangements who may therefore also have little motivation to encourage claims.[714] Cary and Rickard state that 'the availability of funding to facilitate litigation is the most important factor in determining the number of claims.'[715] Securing funding however is difficult as third party funders will only commit to a claim if they are sure the claim has a good prospect of success. Shareholders may find this particularly problematic to show due to a number of reasons. Firstly, there is a lack of any claims to reference (never mind successful claims); secondly, because of this the law is uncertain; and thirdly, shareholders will find it challenging to collect information against the directors' breach due to issues of information asymmetry. 'Action groups may therefore find themselves in an invidious position in which they do not have the funds to investigate a claim fully, but cannot easily raise those funds without that investigation.'[716] UK target shareholders will therefore find it difficult to commence a collective action, in contrast to US shareholders who find it relatively easy.

### 7.3.4 Class Actions: Evidence from Australia

If the UK government did introduce US style class actions; or overhauled the current collective action system, it stands to reason that this could have the effect of increasing the levels of takeover litigation in the UK. Evidence of such a correlation has been seen in Australia.

A US style class action regime was introduced to Australia in 1992, but it was not until the early 2000s that the class action became a mainstay of the legal landscape. Since this time

[713] Norton Rose Fulbright, The adoption of opt-out collective actions in the UK (2015) <http://www.nortonrosefulbright.com/knowledge/publications/130108/the-adoption-of-opt-out-collective-actions-in-the-uk> accessed 14 November 2016
[714] A DBA is an agreement whereby a solicitor and a client can agree to share the risk of litigation. Payment of solicitors' fees, counsel fees and VAT by a client under a DBA is dependent on achieving defined success criteria agreed when the DBA is entered into, and is based on a percentage of the sum recovered from the losing party/opponent
[715] Cary and Rickard (n707) 6
[716] ibid 7



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there has been a rapid growth in Australian class actions,[717] which are now 'a prominent feature of both the Australian legal landscape and the Australian psyche.'[718] One of the main areas in which these class actions are brought is shareholder securities class action, similar to the US. Corporations have consequently faced an unprecedented level of class action litigation. Over the last five years, Herbert Smith Freehills has reported that they have acted for defendants in class actions with a total claim value of more than three billion Australian dollars.[719] Jones Day also recorded that in the first half of 2014 there had been a spike in shareholder class actions, with a number of new entrants threatening or commencing proceedings, mainly around alleged continuous disclosure breaches.[720] So an introduction of different forms of action such as a US style class action in the UK, or removing barriers to those forms that already exist, could have an impact on the levels of litigation. Any impact is however, unlikely to be significant due to the presence of the Panel and the Code, which is the next explanatory candidate to be considered.

### 7.4 Presence of the Panel and the Code

If the UK and the US had identical causes of action, and identical forms of action, it is likely that differences in takeover litigation rates in the two jurisdictions would be more modest. It is however, also unlikely that those differences would disappear, or even substantially reduce. This is because, what is perhaps the most significant difference between the two jurisdictions would remain, namely the presence of the Panel and the Code in the UK (and their absence in the US). This forms our third explanatory candidate. More particularly, we shall argue that the Panel and the Code generally disincentivises, and sometimes wholly precludes, takeover litigation, and that they do so in three principal ways. Firstly, the Panel plays a significant role in solving disputes, and as such provides an efficient alternative to litigation. The Code

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[717]Overview of the Class Action Regime in Australia <http://www.quinnemanuel.com/the-firm/news-events/article-february-2014-overview-of-the-class-action-regime-in-australia/> accessed 05 June 2016 (it must be noted that the rise in levels of class actions has also coincided closely with the rise of third party litigation funding)

[718] Stuart Clarke, Christina Harrisi, 'The Push to Reform Class Action Procedure in Australia: Evolution or Revolution?' (2008) 32 Melbourne University Law Review 775 777

[719] Herbert Smith Freehills, Growth Period Set for Class Action Litigation in Australia (2014) <http://www.herbertsmithfreehills.com/news/news20140228-2014-growth-period-set-for-class-action-litigation-in-australia> accessed 11 December 2016

[720] Jones Day, Class Actions in Australia - 2014 in Review (2015) < http://www.jonesday.com/Class-Actions-in-Australia---2014-in-Review-01-29-2015/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original> accessed 14 July 2016



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additionally manages the behaviour of the directors, which might be the subject of a target shareholder claim in the US. Secondly, the courts refuse to 'step on the toes' of the Panel during the process of a takeover. Thirdly, the no frustration principle prohibits target company tactical litigation that has not been approved by the target shareholders. The US does not have such a system in which takeover disputes can be resolved, and therefore their system relies heavily on the courts to settle these disputes.

### 7.4.1 The Panel as an Alternative to Litigation

The Panel plays a significant role as an alternative to litigation, as it can offer advice and solve disputes via formal and informal procedures. The lack of such a body in the US means that courts are relied on for the resolution of such disputes. The rules of the Code, which are developed by the Panel, are also expansive and cover many issues which are not directly governed by UK regulation. These include rules that stipulate the disclosures required from target directors, which are not dealt with comprehensively or specifically for a takeover scenario by company law. Table 7.2 demonstrates the coverage of the Code rules as compared to UK and US regulation:

**Table 7.2**

| **Table 7.2a - Complainant: Target Directors** | | | | |
|---|---|---|---|---|
| **Complaint** | | **Potential Cause of Action** | | |
| **Target of Complaint** | **Substance of Complaint** | **UK** | **US** | **Takeover Code Provision** |
| 1A. Target Shareholders | 1Ai. Identity of TS | s.793, s.803 CA 2006 | s.13(d) SEA | Rule 5.4, Rule 8 |
| | 1Aii. Concert party arrangements | s.793, s.803 CA 2006 | s.13(d) SEA | Rule 9.1, Rule 8 |
| 1B. Fellow Target Director | 1Bi. Failure to disclose information | Duty of care; s.172, s.174 CA 2006 | s.13(a), s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor | Rule 20.1, Rule 23.1 |
| | 1Bii. Merits of the bid | Duty of care; s.172, s.174 CA 2006 | Directors duty of loyalty and duty of care | Rule 23.1, rule 20.1 |
| | 1Biii. Acting in concert with the Bidder | Duty of care; s.172, s.173, s.174, s.175, s.177 CA 2006 | Directors duty of loyalty, duty of candor and duty of care | Rule 16.2, Rule 24.5 |



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| | 1Biv. Interest in bid | Duty of care; s.172, s.173, s.174, s.175, s.176, s.177 CA 2006 | Directors duty of loyalty, duty of candor and duty of care | Rule 16.2, Rule 24.5 |
|---|---|---|---|---|

| **Table 7.2b - Complainant: Target Directors (continued)** | | | | |
|---|---|---|---|---|
| **Complaint** | | **Potential Cause of Action** | | |
| **Target of Complaint** | **Substance of Complaint** | **UK** | **US** | **Takeover Code Provision** |
| 1C. Bidder | 1Ci. Breach of standstill clause | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) | Breach of contract (specific to each governing State) | |
| | 1Cii. Breach of confidentiality agreement | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) | Breach of contract (specific to each governing State) | Rule 20 |
| | 1Ciii. Failure to disclose or misrepresented information | | s.13(d), s.14(a), s.14(e) SEA ; SEC Rule 14d-1 | Rule 8, Rule 20.1, Rule 23.1, Rule 24.2, Rule 24.3, Rule 25.3 |
| | 1Ciii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests | Directors duty of care | Rule 3.2 |
| | 1Civ. Breach of timetable | | SEC Rule 14e-1 (minimum tender offer period) | Rule 31 |
| | 1Cv. Bidder pressured TS to sell shares | | | Rule 16.1 |
| | 1Cvi. Extension of timetable | | | Rule 31 |

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| Target of Complaint | Substance of Complaint | UK | US | Takeover Code Provision |
|---|---|---|---|---|
| | 1Cvii. Takeover detrimental to long term plans of the target company | | | Rule 24.2 |
| | 1Cviii. Breach of takeover regulations | | s.13(d), s.13(e), s.14(a), s.14(d), s.14(e) SEA; SEC Rule 14d-1 | Breach of any Code rule |
| | 1Cix. Misrepresented information | s.2(1) MA 67 | s.13(a), s.14(d) SEA | Rule 19.1, 19.3 |
| | 1Cx. Value of bid | | | |
| | 1Cxi. Failure to formalise bid | | | Rule 2.7 |

| **Table 7.2c - Complainant: Target Directors (continued)** | | | | |
|---|---|---|---|---|
| **Complaint** | | **Potential Cause of Action** | | |
| **Target of Complaint** | **Substance of Complaint** | **UK** | **US** | **Takeover Code Provision** |
| 1D. Bidder/Government | 1Di. Breach of competition laws | s.75 FTA 73 | s.7 The Clayton Antitrust Act 1914 | |
| | 1Dii. TC is a 'national treasure' or 'jewel company' | | | |
| | 1Diii. Takeover will have detrimental effect to the economy | | | |
| 1E. Advisors | 1Ei. Negligent advice | Duty of care; negligent misrepresentation | Duty of care | |
| | 1Eii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests | Duty of care | |
| 1F. Regulating Body | 1Fi. Decision or ruling | Judicial Review | Judicial Review | |



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| Table 7.2d - Complainant: Target Shareholders | | | | |
|---|---|---|---|---|
| **Complaint** | | **Potential Cause of Action** | | |
| **Target of Complaint** | **Substance of Complaint** | **UK** | **US** | **Takeover Code Provision** |
| 2A. Target Director | 2Ai. TD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 | s.13(a), s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor | Rule 19.1, 19.3 |
| | 2Aii. Failure to disclose information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 | s.13(a), s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor | Rule 23.1, Rule 20.1 |
| | 2Aiii. TD in conflict or not complying with takeover regulations | | | A number of Code rules could be breached |
| | 2Aiv. TD valuation of the share price | Derivative claim for breach of directors duties (s.174 CA 2006) | Directors duty of loyalty and duty of care | Rule 3.1 |
| | 2Av. TD advice on the merits of the bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | s.14(d) SEA; SEC Rule 14d-5, 14d-6; Directors duty of candor and the duty of loyalty | Rule 23.1, Rule 20.1 |
| | 3Avi. TC used takeover defence | Derivative claim for breach of directors duties (s.171 CA 2006) | Directors duty of loyalty and duty of care | Rule 21 |
| | 3Avii. TC used a disproportionate defence | Derivative claim for breach of directors duties (s.171 CA 2006) | Directors duty of loyalty and duty of care | Rule 21 |
| | 2Aviii. TD interest in bid | Derivative claim for breach of directors duties (s.172, s.173 s.174, s.175, s.176, s.177 CA 2006); Part 26; s.994 CA 2006 | s.14(d) SEA; Directors duty of loyalty, duty of candor and duty of care | Rule 16.2, Rule 24.5 |
| | 2Aix. TD knew or ought to have known that the advice given to the shareholders by other professionals was | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | Directors duty of loyalty, duty of care and duty of candor | Rule 19.1, 19.3 |



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| | | | | |
|---|---|---|---|---|
| | negligent or misrepresentative | | | |
| | 2Ax. TD issued new shares | Derivative claim for breach of directors duties (s.171 CA 2006), s.33, s.549 CA 2006 | | Rule 21 |
| | 2Axi. TD knew or ought to have known that bidder would strip company of assets | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | | Rule 23.1 |
| | 2Axii. TD knew or ought to have known that the takeover was detrimental | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Directors duty of loyalty, duty of care and duty of candor | Rule 23.1 |



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| Table 7.2e - Complainant: Target Shareholders (continued) | | | | |
|---|---|---|---|---|
| **Complaint** | | **Potential Cause of Action** | | |
| **Target of Complaint** | **Substance of Complaint** | **UK** | **US** | **Takeover Code Provision** |
| 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority | Derivative claim for breach of directors duties (s.172 CA 2006) | Directors duty of loyalty and duty of care; Breach of controlling shareholders duty | |
| | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted | s.549 CA 2006 | | |
| | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder | | | |
| | 2Biv. New directors/majority have stripped company of assets | s.911B CA 2006 | | |



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| Table 7.2f - Complainant: Bidding Company | | | | |
|---|---|---|---|---|
| **Complaint** | | **Potential Cause of Action** | | |
| **Target of Complaint** | **Substance of Complaint** | **UK** | **US** | **Takeover Code Provision** |
| 3A. Target Company | 3Ai. Breach of timetable | | SEC Rule 14d-9 (recommendations or solicitations by the target company or others) | Rule 31 |
| | 3Aii. TC used takeover defence | | | Rule 21 |
| | 3Aiii. TC used a disproportionate defence | | | Rule 21 |
| | 3Aiv. Failure to disclosure information | Duty of care; s.90A FSMA | s.13(a), s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor | Rule 8, Rule 20.1, Rule 25.3 |
| | 3Av. TD refused to negotiate | | | |
| | 3Avi. Value of bid | | | |
| | 3Avii. TD misrepresented or did not disclose information | | s.14(a) SEA; SEC Rule 14D-9 | |
| | 3Aviii. TD advice to shareholders | | | |
| 3B. Advisors | 3Bi. Negligent advice | Duty of care; negligent misrepresentation | Duty of care | |
| 3C. Regulating Body | 3Ci. Decision or ruling | Judicial Review | Judicial Review | |



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| Table 7.2f - Complainant: Bidding Company | | | | |
|---|---|---|---|---|
| **Complaint** | | **Potential Cause of Action** | | |
| **Target of Complaint** | **Substance of Complaint** | **UK** | **US** | **Takeover Code Provision** |
| 4A. Bidding Directors | 4Ai. Takeover is not in the best interests of the BC | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Directors duty of loyalty and duty of care | |
| | 4Aii. BD did not obtain best price for shares | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Directors duty of loyalty and duty of care | |
| | 4Aiii. BD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Directors duty of loyalty, duty of care and duty of candor | |
| | 4Aiv. BD advice on merits of bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Directors duty of loyalty, duty of care and duty of candor | |
| | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | Directors duty of loyalty, duty of care and duty of candor | |
| 4B. Advisors | 4Bi. Negligent advice | Duty of care; negligent misrepresentation | Duty of care | |

As can be seen form Table 7.2, the Code addresses, and significantly limits, directorial misbehaviour of the type that is sued for in the US. It imposes a prescriptive regime of disclosure rules, regulates target directors' behaviour, and limits their involvement in the decision making process during a takeover. The power to accept the takeover offer is placed firmly with the target shareholders. Consequently, UK target boards are generally able only to give advice on the takeover offer. They do not have the power to accept or reject the bid, unlike target directors in the US who play a greater role in determining the outcome of a takeover bid. Target directors' actions during a takeover in the US are therefore, quite rightly, subject to greater scrutiny by the courts. The need for target shareholders to complain in the



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UK regime is also greatly reduced. In particular the no frustration principle and the mandatory bid rules protect shareholders, and provide the UK system with important checks and balances. The way in which the Code is developed, (i.e. it is not black letter law) additionally means that the Panel can pre-empt changes in market practices and adapt the Code quickly to such changes, and as such the rules are always up to date.

The Panel's Executive also precludes and disincentives the use of litigation as it regulates and supervises takeovers on a day-to-day basis. This includes, either on its own initiative or at the instigation of third parties: the conduct of investigations, the monitoring of relevant dealings in connection with the Code and the giving of rulings on the interpretation, application or effect of the Code. The Executive is additionally available both for consultation and also the giving of rulings on the interpretation, application or effect of the Code before, during and, where appropriate, after takeovers or other relevant transactions.[721] This is something courts cannot reasonably be expected to do. As well as regulating firm offers, the Executive also 'undertakes a substantial volume of work in respect of possible offers, whitewashes, concert party queries, re-registrations and other general enquiries relating to the application of the Code, much of which does not become public.'[722] The Panel relies upon the co-operation of parties to a takeover and Section 6(b) of the Code imposes 'an obligation upon a relevant person or its advisers to consult the Panel if they are in "any doubt whatsoever" as to whether a relevant proposed "course of conduct" is in accordance with the Code.[723] Once that 'very low threshold of doubt is reached the Panel must be consulted.'[724] The Executive may also be approached for general guidance on a "no names" basis, where the person seeking the guidance does not disclose to the Executive the names of the companies concerned.[725] Again, this is a practice which the courts would not easily be able to adopt and is a significant advantage of the Panel as a regulator.

[721] Takeover Panel <http://www.thetakeoverpanel.org.uk/structure/executive> accessed 11 January 2016
[722] The Takeover Panel Report on the Year Ended 31 March 2015 <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/935766_TakeOver-AR_web-version1.pdf> accessed 20 December 2015
[723] The Takeover Panel, Asia Resource Minerals plc (formerly BUMI plc): Statement of Public Criticism of Credit Suisse, Freshfields and Holman Fenwick, 2015/15 (2015) para 5.2
[724] ibid
[725] The Code para 6(a)



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As such, in the UK, the Panel is the first port of call if there are any issues which arise during a takeover. This is reflected in the data collected in chapter four, which shows that the Panel has made 35 formal rulings in the last five years,[726] compared to five cases which reached the courts.[727] It is not clear how many decisions are made, or how many queries are brought before the Panel as these statistics were not available. As noted during the interviews with the UK Lawyers,[728] the Panel is constantly providing informal advice to companies on a daily basis. Often this guidance is a phone call away, and complaints can also be lodged just as quickly. As the Panel provides guidance to parties, this may also preclude complaints from arising at all because they can be quickly resolved. The appeals system that exists within the structure of the Panel and the rules of the Code means that rulings of the Panel can be challenged. If there is a grievance between the parties then it should be resolved within the system of the Panel, and once this comprehensive appeal system has been exhausted it is unlikely that parties would still wish to go to court. Moreover, due to the Code's soft law nature, a breach of the rules cannot be enforced by the courts. Under s.955(3) of the CA the only person who can seek an injunction for a breach of the Code is the Panel itself. This will also significantly impact upon the level of litigation in the UK. The US does not have a similar system in which complaints can be dealt with or advice given from a statutory body, without bringing litigation. Furthermore, academics have noted that the role of the courts in the US plays a role in encouraging litigation.[729] This is not because the courts actively and directly encourage litigation, but do so due to the way in which they approve settlements and fee awards. [730]

### 7.4.2 The Courts' Refusal to "Step on Toes" of the Panel

It is not just the Panel which is cautious of litigation. Traditionally, the UK courts have also taken a non-interventionist stance when dealing with cases during a takeover bid, in contrast to the US courts.[731] The non-interventionist policy was established in the UK in a number of cases, but most prominently in Datafin.[732] In this case, it was made clear that the relationship

[726] See Table 4.13
[727] See Table 4.6
[728] See appendix one
[729] See Fisch et al (n563) 608
[730] See Fisch et al (n563)
[731] Though, if the US courts took a non-interventionist stance there may be access to justice issues because this is the only way at the moment in which complaints can be settled.
[732] Datafin plc (n268)



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between the Panel and the court would be "historic rather than contemporaneous," and therefore the court would allow the Panel's decisions to take their course.[733] Sir John Donaldson MR justified this response by stating that:

*'when the takeover is in progress the time scales involved are so short and the need of the markets and those dealing in them to be able to rely on the rulings of the Panel is so great that contemporary intervention by the court will usually either be impossible or contrary to the public interest.'*[734]

The principle set in Datafin has been affirmed in two later judicial review cases brought against the Panel, in Guinness[735] and Fayed.[736] In Guinness, although the Court of Appeal condemned the Panel's decision as "insensitive and unwise", it still declined to intervene.[737] It stated that although the Panel's executive investigations could have been pursued more thoroughly, there was public interest in the Panel acting to enforce the Code and, because no injustice had resulted from the Panel's actions, the case was dismissed.[738] Similarly in Fayed, the Court of Appeal declined to intervene because it could not be shown that there had been bad faith on the part of the Panel or an injustice caused to the claimant.[739]

In Datafin the courts held that they would allow the Panel's contemporary decisions to take their course, and then would consider the complaint, and intervene 'if at all, later and in retrospect by declaratory orders.'[740] Whereas in Dunford and Elliot, a case not concerning judicial review but a conflict of interest, the court noted that the particular issue that arose was 'perhaps a problem which may hereafter require consideration by the Panel to avoid any possible future conflict of interests, if indeed they are not already considering it.'[741] The judgment in Dunford and Elliot suggests that the court will intervene in some cases when the takeover is ongoing, and direct the Panel to potential issues in which to make a ruling at a

[733] Datafin plc (n268) 842
[734] R v Panel on Takeovers and Mergers ex parte Guinness [1989] 1 All ER 509 per Sir Donaldson MR [512]
[735] ibid
[736] R v Panel on Takeovers and Mergers ex parte Fayed [1992] BCLC 938
[737] Guinness (n734); see also Mukwiri (n2)
[738] ibid
[739] Fayed (n736)
[740] per Sir John Donaldson MR, Datafin (n268) 842
[741] Dunford and Elliot Ltd v Johnson & Firth Brown Ltd [1977] Lloyd's L Rep 505 per Roskill LJ [156]



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later date.[742] These two cases seem to draw a distinction between judicial review cases and non-judicial review cases.

7.4.2.1 Courts Approach to Litigation in Schemes of Arrangements

The court has a significant role to play in schemes because they require a sanction by the court, as set out in Part 26 of the CA. As such, in the case of a scheme there is a dual jurisdiction, of both the Panel and the court.[743] There is, therefore, the possibility that the process could undermine the function of the Panel. This could then lead to an increase in the levels of litigation used in takeovers. This possibility was however removed by the courts in Re Expro International Group plc ('Expro').[744] In this case the courts stated that 'one of the purposes served by the Code is to bring a degree of certainty in the conduct of bids for the benefit of all shareholders.'[745] Litigation would understandably affect this certainty and therefore the courts eliminated the opportunity for this to occur.

The facts of this case will be outlined to highlight this issue. A recommended offer was made for Expro, by a company called Umbrellastream. The takeover was to be implemented by way of a scheme. A meeting of Expro's shareholders was convened to approve the scheme with Umbrellastream, however, another company, Halliburton, announced that it was conducting due diligence on Expro with a view to possibly making a competing offer. Expro's board announced that it had received a private proposal from Halliburton but the proposal did not amount to a firm intention to make an offer and was subject to pre-conditions. Under the circumstances the shareholder's meeting to approve the original scheme was adjourned for a week and a circular was sent to the shareholders. The circular recorded terms reached between the company and Umbrellastream, whereby the company agreed not to seek to postpone or further adjourn either the shareholders' meeting or the court hearings for the sanction of the scheme and a confirmation of reduction of the capital involved in it. Expro shareholders, in the knowledge that Halliburton had put forward a non-binding proposal to Expro's board, later voted to approve the Umbrellastream scheme.

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[742] This was an urgent case that was considered during the takeover
[743] See Re Expro International Group plc [2010] 2 BCLC 514 520
[744] ibid
[745] ibid per David Richards J 517



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Halliburton then made a last minute increased offer on terms that the company would, without necessarily recommending the proposal, co-operate with the proposal being put to shareholders in a scheme of arrangement. The company's board concluded that the additional 10p per share over Umbrellastream's offer was insufficient for them to agree to Halliburton's proposal. At the court hearing seeking the court's sanction of the scheme with Umbrellastream, certain shareholders of the company appeared and sought an adjournment of the company's application for the sanction of the scheme for 14 days. The purpose of the adjournment was to give Halliburton the opportunity to make a further bid for the company. The shareholders submitted that the board appeared not to have taken into account the acceptance of Halliburton's proposal which would have triggered an orderly auction process overseen by the Panel under the provisions of Rule 32.5 of the Code, and that such an orderly auction process could have resulted in an increased price to the benefit of shareholders.

The court held that the board, on the evidence at hand, had considered the possibility of an auction process, and whether it could lead to a higher price. The board had concerns that it could not, and the court found that no criticism could be made of the board's assessment of the relative benefits and risks associated with accepting or rejecting Halliburton's final proposal. The certainty of Umberellastream's offer which could become fully effective in a short time outweighed commercially either a firm offer from Halliburton or the uncertainty of a higher offer in due course. The uncertainty inherent in the potentially competitive situation created by Halliburton's interest was well known and clearly addressed in the relevant circulars to the shareholders.[746]

In regards to the shareholder's application for adjournment the court stated that:

*'I have approached this application by the shareholders…entirely on its own merits and in accordance with the established principles applicable to the consideration of schemes of arrangement. I none the less should say that I have concern that there should, if possible, be a common approach to the conduct of bids, whether they are structured as an offer or as a scheme. I would not think it desirable that the court procedure involved in a scheme should*

[746] Expro (n745)



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*allow in an undesirable level of uncertainty which the provisions of the Code have successfully reduced or eliminated in the case of ordinary offers.'*[747]

Whilst the courts made it clear in this case that although they must be involved in sanctioning schemes the Panel is still the main regulatory body and therefore it is the decision maker regarding the conduct of takeovers. Payne notes that this decision removed the uncertainty that there may be a two–track system where there was a possibility for litigation during a scheme of arrangement.[748]

In reaction to this ruling the Panel stated in their end of year report:

> *'In the recent High Court judgment…it was noted that it was not considered desirable for Court procedure to introduce a level of uncertainty into offers which the provisions of the Code had successfully eliminated. On this evidence, it does not appear that there is any current likelihood of the Courts playing a more active role in determining the outcome of offers.'*[749]

The Panel were "unusually…perhaps uniquely"[750] represented in these proceedings. Payne noted that having just introduced the new provisions to the Takeover Code in January 2008 to codify the Panel's practice and to clarify the Code timetable in relation to schemes, 'the Panel was concerned that a successful application for an adjournment by the dissentient shareholders in this case might create just the kind of uncertainty in the context that the Code changes were intended to reduce.'[751] It is therefore clear that the judge was 'keen for the courts involvement in schemes not to create this process.'[752]

[747] Expro (n745) per David Richards J 524
[748] Payne (n143) 112
[749] The Takeover Panel, 2007-2008 Report <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/report2008.pdf> 14 accessed 15 July 2016
[750] Expro (n745) per David Richards J 524
[751] Payne (n143) 112
[752] ibid



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### 7.4.3 The No Frustration Principle and Tactical Litigation

So far this chapter has focused on explaining the "litigation mountain" that differentiated the US and UK landscapes, but as noted in the introduction, the similarities or "flatlands" of both landscapes are also worthy of discussion. The flatlands here represent the lack of tactical litigation instigated by the target company in both the UK and US. Tactical litigation can be defined as litigation which is undertaken during the course of the takeover process prior to the completion of the takeover in order to discourage or hinder the bidder.[753] Potentially, tactical litigation can be commenced by any party to a takeover subject to each jurisdictions rules and regulations. For the UK, the lack of tactical litigation commenced by target directors is explained by the existence of Rule 21 of the Code, the "no frustration principle," the hesitance of the Panel and the Court to allow tactical litigation, and other pieces of company law. For the US, the explanation for the lack of target company instigated litigation is that target directors do not need to use tactical litigation because they have other, non-litigious, tactical moves which they can use to influence the outcome of a takeover.

It is true that the Code, including specifically Rule 21, does explain part of the 'flatlands', in the sense of a general absence of tactical litigation brought *by* target directors (or by the target company on their decision) against the predator. The no frustration principle however is assumed to be the most obvious reason in explaining why there are differing levels of litigation between the UK and the US, in total. Rule 21 cannot, however, explain the absence, in the UK, of the TSvTD spike. This is because the no frustration principle states that *the board of the target company* cannot take any action which may frustrate an offer, which either has been formally made or which they have reason to believe will be made, without the consent of the shareholders.[754]

The target company is therefore the only party who is prevented from bringing tactical litigation during a bid under this rule. It would therefore be possible for target shareholders, bidders and the bidder's shareholders to commence litigation during a bid in the UK.

[753] Tactical litigation has been defined by the UK's Department of Trade and Industry ("DTI") as 'legal proceedings taken by parties to a bid with a view to frustrating or hampering the bid or the defence of a bid' see DTI, Consultative Document (London, January 2005) 15 para 2.32

[754] Code Rule 21



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Additionally, due to the wording of this provision, tactical litigation can still be brought during a bid by the target directors on behalf of the target company when the target shareholders' approval has been obtained. Rule 21 therefore only precludes a certain type of litigation, specifically tactical litigation commenced by the target company without the consent of the target shareholders. It cannot therefore explain completely the UK's lack of takeover litigation.

In contrast, the target directors in the US are able to commence litigation without first obtaining the target shareholders consent. Whether tactical litigation (or any other defence) is undertaken by the target company is in the control of the target directors. As long as the target directors abide by the standards set under the business judgment rule, and the enhanced scrutiny tests under the Revlon[755] and Unocal,[756] the target directors can decide whether litigation should be under taken. Shareholders will not usually have a say in whether a defence, such as tactical litigation is used.[757] Nevertheless, the transplantation of the no frustration principle to the US system would not significantly reduce their levels of litigation either. This is because the main instigator of tactical litigation in the US is the target shareholder, who is not prevented from commencing litigation under this rule. It would only have an effect on the target directors' ability to commence tactical litigation without the consent of the shareholders. As stated, directors in the US do not need to use tactical litigation if they wish to stall or prevent a takeover; this is because they can use takeover defences which would be more effective than commencing litigation.[758]

It could be argued that if the no-frustration principle was removed from the regulation of takeovers in the UK, the levels of target company tactical litigation would increase. In the UK the target company commenced 14 percent of the cases recorded.[759] Whilst this number of cases is half of those instigated by the target shareholders or bidders, the number is not insignificant. However, tactical target company litigation is not only restricted by Rule 21 (even if they have shareholder consent). This is because the Panel has made it clear that they

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[755] Revlon (n444)
[756] Unocal Corp (n443)
[757] This also explains the lack of target company litigation in the US, because they are able to use other more effective defences to ward off an unwanted takeover without the consent of the shareholders (such as the poison pill which is prohibited in the UK under the no frustration principle).
[758] See Armour, Skeel (n34)
[759] See Table 4.8



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should first be consulted before any proceedings are commenced. In Dunford and Elliott v Johnson and Firth-Brown[760] in which there was a request to the court for an injunction, Lord Denning MR stated in his ruling that the very moving for an injunction would seem to be a breach of the General Principle of the Code; seeing that it is an action which is designed to frustrate the making of a bid.[761] Shortly after, the Panel issued a statement affirming:

> *"If the board of an offeree company contemplates legal proceedings in relation to an offer or prospective offer, problems may in certain circumstances arise under the Code. The board would therefore be well advised in such a case to consult the Panel before any action is taken."*[762]

This statement addresses tactical litigation brought by target companies more specifically, and seems to advise that even when the consent of target shareholders has been obtained the Panel should still be consulted prior to the commencement of litigation. The Panel was able to offer further insight into their stance on tactical litigation in their own 1989 ruling regarding Minorco and Consolidated Gold Fields.[763] In this case the Panel were unexpectedly, more favourable towards the idea of litigation, stating that they would be 'reluctant to interfere with the taking of legal action by parties to an offer, and would not lightly seek to preclude a party from pursuing proceedings which could legitimately be brought before a court whether in the UK or in an overseas jurisdiction.'[764] The Panel, however, went on to clarify that legal proceedings might, depending upon their nature and timing, give rise to a potential conflict with the provisions of the Code.[765]

Despite this, some tactical litigation has been commenced in the UK. Perhaps the most significant of these cases is Marks and Spencer Plc v Freshfields Bruckhaus Deringer.[766] In this case the target firm, Marks & Spencer (M&S) made an application to request an injunction prohibiting Freshfields Bruckhaus Deringer (Freshfields) from acting for, or advising, or otherwise assisting the potential bidder (who had instructed Freshfields to act on their behalf). M&S, who retained Freshfields as one of its legal advisers, contended that by

[760] Dunford and Elliott (n741)
[761] ibid at 510
[762] Consolidated Gold Fields plc (n207)7
[763] ibid
[764] ibid 6
[765] Consolidated Gold Fields (n207) 7
[766](n272)



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acting for the bidder in circumstances where Freshfields had an existing and on-going retainer, in relation to one of their main contractual arrangements and their restructuring, had placed themselves in a position of a conflict or a potential conflict of interest to which they had not consented. In addition, M&S maintained that as a result of the services performed by Freshfields over a number of years, they were in possession of confidential information belonging to them which was or might be relevant to the retainer which Freshfields had obtained with the bidder. The court held that a huge amount of confidential information relating to the affairs of M&S was held within Freshfields which was plainly, material to a potential bid. The court therefore granted the injunction. The outcome of these legal proceedings therefore significantly altered the tactical dynamics of the bid for M&S.

The grounds for bringing the claim (which was the release of confidential information) were identical to that of Dunford and Elliott. Why then did the commencement of the M&S tactical litigation, which altered the outcome of a takeover bid, not breach the Code, but the granting of an injunction in the case of Dunford and Elliott could amount to a breach? One possible answer is that the court in Dunford and Elliott held that the information released, on the facts of the case, was actually not confidential.[767] The Panel has not illustrated when a claim will not be in conflict with the Code, and therefore the situation in which the Panel may allow tactical litigation to proceed is unclear. The Panel itself has however implied that they are unable to clarify their position until a specific case of this nature comes before them.[768]

The Panel has noted that target company tactical litigation could be potentially detrimental but whether a claim should be commenced is at the discretion of the target shareholders:

*'[L]itigation could become a tactical weapon intended to prevent a bid from being considered on its merits. All this could take place regardless of the views of the shareholders who own the company. We think that, in principle, this would be highly undesirable and potentially gravely damaging to the orderly conduct of bids. In saying this, we are not suggesting that it may not be appropriate to take legal proceedings which frustrate a bid. All*

[767] Dunford and Elliot (n741) [148]
[768] Consolidated Gold Fields (n207) [9]



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*we are saying is that the shareholders should be entitled to decide whether such actions should take place.'*[769]

This emphasises, again, the importance of the director not being able to take away the target shareholders' ability to decide on the outcome of the takeover, and prioritises using the Panel as the first port of call.

Company law also precludes the use of tactical litigation. This would be the case, even if Rule 21 were to be removed from the Code. The CA sets out specific regulations in regards to complaints, and renders it difficult for any tactical litigation to commence. For instance, sections 945, 951, 955, 956 and 961 CA are:

*'intended to limit litigation by…channeling parties to seek decisions of the Panel (including the Panel's Hearings Committee and the independent Takeover Appeal Board) before having recourse to the courts…'*[770]

This again, encourages parties to a takeover to first approach the Panel. This is designed to ensure clear and transparent takeovers, and to safeguard the length of time it takes to undertake takeovers (which should be kept to a minimum). If parties to a takeover do consult the Panel first, and a decision is made, then there should be no need to pursue complaints as litigation. Rule 21's suppressing effect on litigation does not therefore explain much here; nor does the absence of such a rule in the US explain the propensity to litigate.

### 7.4.4 The Australian Takeover Panel: a Point of Comparison

It is difficult to quantify the precise impact of the Panel's presence in the UK, and the lack of such a body in the US, on these jurisdictions' different levels of litigation. We cannot, for example, carry out an 'event study,' where we measure litigation levels before, and after, the creation of the Panel and the Code, and deduce therefrom the impact this creation had. What can be used in support of this explanation however is the impact of the adoption of a Panel like body in Australia.

[769] Consolidated Gold Fields (n207) 9
[770] Companies Act 2006, Explanatory notes, Chapter 1, 1177



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The Panel in Australia was originally established in 1991 as a 'means of enforcing the purposes underlying the takeover provisions.'[771] In establishing a new system of takeover regulation, the Corporate Law Economic Reform Program ("CLERP") reforms had four key aims. These were to: (i) inject legal and commercial specialist expertise into takeover dispute resolution; (ii) provide speed, informality and uniformity in decision-making; (iii) minimise tactical litigation; and (iv) free up court resources.[772] Data does not exist to demonstrate the exact effect the Panel in Australia has had on the levels of takeover litigation. However, Armson notes that 'statistics collected to assess the use of the new Panel, raised questions as to whether the CLERP reforms had merely resulted in 'tactical litigation' under the old regime being replaced by multiple applications to the Panel.'[773] This therefore suggests there has been a reduction in takeover litigation reaching the courts in Australia due to the new presence of the Australian Panel, despite the increase in litigation after the introduction of US style class actions.

## 7.5 Litigation Culture

The final explanatory candidate is "litigation culture" which is a term that is sometimes used as a label merely to describe (rather than to explain) a high rate of litigation. This is not, however, the meaning that is employed for this term in this section. Instead litigation culture is defined as the *features* of a particular culture in the UK or US that might explain the high rates of litigation. For example, Kritzer described litigation culture as a set of norms and attitudes (including formal legal norms), and established expectations, practices, and informal rules of behaviour of judges and attorneys.[774] One might assume that the explanation for the different levels of takeover litigation in the UK and US arises from these differences in litigation culture.

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[771] Emma Armson, 'An Empirical Study of the First Five Years of the Takeovers Panel' (2005) 27 Sydney Law Review 665, 666

[772] ibid 668; Commonwealth Treasury, 'Corporate Law Economic Reform, Proposals for Reform, No 4, Takeovers – Corporate Control: A Better Environment for Productive Investment' (Canberra, 1997) 32; See also Explanatory Memorandum accompanying the Corporate Law Economic Reform Program Bill 1998 (Cth) 28.

[773] Armson (n) 674

[774] Herbert M Kritzer, Frances Kahn Zemans, 'Local Legal Culture and the Control of Litigation' (1993) 27 Law Society Review 535



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Whilst it is rather easy to compare the levels of litigation in different jurisdictions and conclude that one has a greater level than the other, it is not easy to pin-point what aspects or behaviours make up a particular litigation culture, and then demonstrate that those aspects actually do have an effect on levels of litigation. What this section will now go on to show is that some elements of culture are tied to factors that are plausible explanations, whilst others are not. The aspects of takeover litigation culture that are the focus here are the characteristics of each system that would seem to provide the most plausible explanation for the UK and US's particular takeover litigation culture. These aspects are acceptability of litigation, positive attitude towards litigation and behaviour and litigation etiquette.

7.5.1 Acceptability of Litigation

Litigation culture can often refer to a public moral acceptability that litigation is a tool that can be used to settle problems or disputes. A report commissioned by Norwich Union indicates an increase in the UK's acceptability to litigate. The report found that 96 percent of those asked believed that individuals in the UK were more likely to litigate than over a decade ago, and 47 percent stated that they themselves would be more likely to litigate today as compared to their previous attitude.[775]

Many factors may contribute to an acceptability of litigation which could in turn create a litigious culture. For example, Mattei suggests that an increased awareness about the right to claim can contribute to a moral acceptability of litigation.[776] The advertising of law firms may also contribute to this awareness and moral acceptability.[777] Both the UK and US offer a fully advertised market for legal services which will certainly have an effect on the acceptance and general levels of litigation.[778] There is also a lack of social stigma when commencing litigation in the UK and the US.[779] This can be contrasted with other

[775] Norwich Union Report, 'Public attitudes to 'blame and claim' culture revealed' (2004); see also Frank Furedi, Jennie Bristow, The Social Cost of Litigation, Centre for Policy Studies (2012)
[776] Ugo Mattei, 'Access to Justice. A Renewed Global Issue?' (2007) 11 Electronic Journlal of Comparative law 1. 10
[777] Compensation Bill [HL] Bill 155 of 2005-06 Research Paper 06/28 (19 May 2006) <http://researchbriefings.files.parliament.uk/documents/RP06-28/RP06-28.pdf> accessed 13 May 2016
[778] Mattei (n776) 10
[779] ibid 8



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jurisdictions such as China and Japan.[780] Mattei found that there was social stigma surrounding litigation in these countries; noting that in China (mostly in the countryside) where someone suing or being sued is likely to be subject to "humiliation and dishonor" affecting the whole family, clan, and even in laws.[781] Considering these particular factors the UK and US do display similar acceptability towards litigation. This acceptability of litigation is however perhaps rather vague, as what is acceptable may entirely depend upon the very specific litigation that is being undertaken. For example, it may be much more acceptable to sue a stranger for a personal injury suffered in a car crash than it is to sue an employer for a work related injury. The acceptance of takeover litigation may therefore be entirely different from the public's overall attitude towards litigation.

Whilst there has been an increase in acceptability of litigation in the UK, and correspondingly an increase in levels of litigation generally, there has not been a similar effect on the culture of takeover litigation in the UK. This can be demonstrated by the lack of a comparative increase in takeover litigation in the UK when compared to the public's increase in acceptability of litigation in general.[782] The data in chapter four shows that takeover litigation rarely occurs, and has remained at a steady rate for a number of decades. It is a little more difficult to decipher whether acceptability of litigation in the US has had any effect on their specific takeover litigation culture, and therefore the greater levels of takeover litigation. Mattei however, noted that these data recording of the US "explosion" in litigation demonstrates that there has only been a rough increase of 15 percent in the litigation rates from 1993 to 2001[783]. By contrast, Cain and Davidoff Solomon reported an increase in takeover litigation of 55.9 percent from 2005 to 2014.[784] These data show that there has been a higher increase in the levels of takeover litigation than general litigation in the US.[785] As such the increase in takeover litigation may not be attributable to the same factors that have

[780] Mattei (n776) 8
[781] ibid
[782] Measures to disincentivise certain types of claims (such as personal injury and medical negligence claims) from commencing have been put in place by the British Government due to a concern in the rise of litigation rates; see Compensation Bill Research Paper 2006, Consultation Paper CP 13/10 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/238368/7947.pdf;> accessed 17 February 2016
[783] Mattei (n776) 9
[784] See Cain, Davidoff Solomon (n537)
[785] These data are difficult to compare as the dates recording the explosion in litigation and takeover litigation are over different periods of time; therefore there may have been a more significant increase in litigation more generally after 2001. However, the litigation explosion during that period is thought to have been the point in time where the US experienced the sharpest rise in litigation.



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led to this general increase, and may be due to other more significant causes. However, there may be a greater acceptance of takeover litigation in the US because it occurs in 95 percent of transactions.[786] Statistics gathered by Fisch et al also show that multiple teams of plaintiffs file lawsuits 'challenging virtually every public company merger,' and often in multiple jurisdictions.[787]

In the US, litigation may be expected as part and parcel of the takeover process. This acceptance could, of course only be a side effect of the scale in which takeover litigation occurs in the US. Whether the acceptability to litigate added to the litigation culture before, during or after the high levels of litigation in takeovers were recorded in the US would be difficult to conclusively show. What may be implied is that litigation commenced during a takeover in the US is now an accepted practice and almost certainly part of the US takeover litigation culture. By contrast in the UK, takeover litigation does not seem to be an accepted part of the process because it rarely occurs. It is, however, extremely difficult to prove that the litigation does or does not occur because it is accepted, as attitudes of acceptability may have arisen due to other factors.

### 7.5.2 Positive Attitude towards Litigation

If a claim is relatively easy to bring and garners results then it could be assumed that the attitude towards bringing litigation would be positive. There are a number of factors which can make pursuing a claim easier. For example, the method in which a claim is brought can have a significant impact upon the ease of pursuing a claim. In the US, shareholders have class actions available to them, a form of action which is easier to commence than a derivative claim. If the form in which a claim can be brought is easier for shareholders to navigate in the US than in the UK, then litigation is more likely to be accessible to those shareholders. Another factor which increases the ease in which a claim is brought is access to lawyers and judges. In the study completed by Ramseyer and Rasmusen it was found that the

[786] See Cain , Davidoff Solomon (n537)
[787] Fisch et al (n563) 558



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US has 10.81 judges and 391 lawyers to every 100,000, whilst the UK has only 2.22 judges and 251 lawyers per 100,000 people.[788]

The US does have more judges per capita, and also more, but not many more, lawyers per capita than the UK.[789] It is true that parties to a takeover in the UK will most likely have access to lawyers, however what they may not have access to is the courts. There are two reasons for this, firstly the courts in the UK are very reluctant to hear a case whilst a takeover is occurring, and secondly because the no frustration principle limits a target company's ability to bring litigation during a takeover. Target shareholders and bidders in the UK are however only affected by the first limitation. Their access to the courts would not be limited by the no frustration principle.

Takeover litigation also generally garners better results for those in the US than in the UK. Cain and Davidoff Solomon found that over 70 percent of the cases recorded in their US data settled. Whilst the vast majority of settlements result in additional disclosures,[790] the act of litigating is arguably used more as a tactical manoeuvre and may therefore result in benefits not directly linked to the settlement of the claim, such as an increased offer or a change to the terms of the deal. In contrast, 73 percent of takeover litigation is unsuccessful in the UK.[791] As such there may be more of a negative attitude towards bringing litigation in the UK. If there is a positive attitude towards bringing takeover litigation in the US, this may have been determined by the structural components of the US system, and therefore these components would be the likely explanation for the increased levels of litigation, rather than culture specifically.

### 7.5.3 Behaviour and Takeover Etiquette

The presence of the Panel in the UK has created a certain way of behaving during the course of a takeover, and as such has created a unique "takeover etiquette" in the UK. The historical

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[788] Ramseyer, Rasmusen (n657) see Table 1
[789] ibid
[790] Daines, Koumrian (n526) (They found that over 50% of the settlements they recorded were disclosure only);
[791] See chapter four section 5.1.4



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development of the Code and the Panel explains the development of this culture.[792] This is because UK institutional investors pre-empted public regulation by taking charge of the development and enforcement of the Code.[793] Armour and Skeel note that the enforcement of soft law rules developed in the Code was feasible in the UK, because of the specific environment where parties interacted repeatedly within the square mile of London.[794] 'As repeat players, the institutions were able to agree on a mode of takeover regulation that was much cheaper than litigation, and to threaten reputational sanctions, like exclusion from the market, against those who refused to comply with the Code or Panel rulings.'[795] This created an environment where those involved in takeovers generally behaved "well." This was because the same people dealt with each other on a regular basis, and the fear of sanctions from those same peers reinforced the good behaviour. The Panel's presence strengthens the traditional culture of compliance by providing an alternative to litigation, using their rulings based system, and by severely sanctioning those who do not follow the rules. Consequently a takeover litigation culture has not been able to develop in the UK.

Such an environment is less evident in the US. In the absence of the Panel, and the (generally) good behaviour created by the square mile, the US has had to rely on the courts for a solution to complaints. Yates et al reason that 'the differences in the elemental structure of the judicial system, or system in which complaints are handled, affect the degree to which the legal system is invoked for redress.'[796] This is true of the different systems in the UK and US, as the different ways in which takeover complaints can be handled has ultimately impacted upon how often the courts are called upon to settle disputes. Furthermore Jacobi, claims that the more capable the judges are of providing forms of redress, the more effective threats of litigation become, which in turn increases the extent to which litigation can be used as a strategy, even when it is not ultimately pursued.[797] Delaware courts are extremely experienced in corporate law and are well equipped to handle takeover cases and provide

[792] See Armour, Skeel (n34)
[793] ibid 1771
[794] ibid 1772
[795] ibid
[796] Jeff Yates, Holley Tankersley, Paul Brace, 'Assessing the Impact of State Judicial Structures on Citizen Litigiousness' (2010) 63 Political Research Quarterly 796 , 796
[797] Tonja Jacobi, 'The Role of Politics and Economics in Explaining Variation in Litigation Rates in the U.S. States' (2009) 38 The Journal of Legal Studies 205, 212



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forms of redress to parties. By contrast, the courts in the UK prefer to let the Panel handle such disputes due to their own particular expertise and power.

The US is not, contrary to perception, inherently drawn to commencing litigation but guided towards it as a means by which to solve disputes because it is allowed, easily commenced and because it garners results. This could contribute to an explanation as to why the US has a propensity to litigate during takeovers. The presence of the Panel in the UK, and the special proximity in which it operates in London have entrenched a certain compliance culture that may also explain why there is a lack of a propensity to litigate in the UK. However as Siems notes:

*'[O]ne has to be careful about making too confident an assumption about the relationship between litigation rates and legal cultures. It is also important to note that cultural and structural determinants for litigation are mutually interdependent: on the one hand, structures may be a reflection of cultural values, but, on the other hand, cultures can also change, which may, in part, be determined by structural decisions.'*[798]

Cultural factors that some assume affect the disparity in the levels of litigation between the UK and US, such as the US being more prone to litigation due to an aggressive nature, or having more lawyers, do not seem to provide a plausible explanation here. An explanation in terms of such attitudes must hold that target shareholders in the US have this attitude, but target shareholders in the UK do not. But given the globalisation of share ownership, the target shareholders in a US takeover will often include British institutions, and in a UK takeover will include US institutions. If the US experiences more litigation because US shareholders are culturally disposed to sue, then those same US shareholders would display a similar cultural disposition to litigate in respect of their UK investments. UK investors in US companies would therefore be as likely as their fellow US investors to litigate in the US, when the US companies in which they have invested becomes a takeover target. What this suggests is that something other than a national stereotype about "attitudes" to suing explains what's going on.

[798] Mathias Siems, *Comparative Law* (Cambridge University Press 2014) 132



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There is however some truth in the cultural explanation. The existence of the Code in the UK, and its creation of an alternative means of disciplining target directors, and of a climate in which allegations of misbehaviour by target directors are expected to be settled through the Code/Panel, are essential elements of the specifically-takeover related culture in the UK. Other elements such as the acceptability of takeover litigation in the US takeover process may be a factor in explaining the disparity, but it would be difficult to conclusively conclude that levels of litigation increased because commencing takeover litigation is an accepted practice, or that it became an accepted practice due to the increase in litigation. US parties to a takeover may also have a more positive attitude towards commencing takeover litigation because they have more access to the courts and are more likely to be successful.

## 7.6 Conclusion

This chapter has considered four candidates to explain the takeover litigation landscapes of the UK and the US, and especially to explain the key difference between those landscapes. That difference is the significant spike in US litigation, where target shareholders routinely sue target directors, a spike quite absent from the UK. It has been argued that none of the four candidates alone causes this difference; rather that each contributes to it. If the ingredients which constitute any one of the four candidates ceased to exist, the differences between the UK and the US would likely be reduced, but would not wholly disappear.

The first explanation focused on differences in the causes of action enjoyed by US and UK shareholders. We found some truth in this, partly because target directors are under more extensive obligations (and especially disclosure obligations) than UK directors are, but also, and much more significantly, because of differences in the identity of the party to whom these obligations are owed. The US treats such obligations as owed both to the company, and directly to shareholders. The UK generally treats such obligations as owed only to the company. In consequence, US shareholders enjoy extensive rights to bring personal claims against directors; UK shareholders only have such rights in much rarer, exceptional, cases.



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These differences, in the underlying causes of action, are then compounded and reinforced by differences in the forms of action between the two jurisdictions, which is the second explanatory candidate. As the UK causes of action are enjoyed by the company, not by shareholders personally, litigation in the UK must be brought by the company itself, or by shareholders suing derivatively, on its behalf. If derivative proceedings in the UK were easy to bring and sure to succeed, and if they delivered tangible benefits into the pockets of shareholders taking on the burden of suing, then the significance of differences in the *causes* of action would be mitigated, and the flow of UK cases would likely be much greater. As we saw, however, none of that is true for derivative proceedings in the UK. Similarly, if the forms of action in the US for enforcing personal claims were more hazardous, and offered less incentive to sue, then we would likely see far less US litigation, notwithstanding its readiness to create a personal cause of action in respect of directorial disclosure obligations. This is not how things are, thanks largely to the US class action, and especially to the fee orders which underpin that action.

The availability of the class action encourages many more shareholders to bring personal actions; but that number would likely still be more modest than in fact it is, if it were not for the tendency of lawyers themselves to encourage personal claimants to launch and continue more claims. The personal action gives the kindling; the class action encourages more shareholders to strike the match; and the lawyers pour the petrol on the flames for reasons of self-interest. Finally, the US class action is far more productive of litigation than either of the UK's semi-equivalent collective action procedures. So, even where UK shareholders do, exceptionally, enjoy a personal cause of action, such as for breach of s.90 FSMA, they must pursue this by forms of (collective) action, the GLO or the representative action, that are significantly less attractive, either for shareholders or their lawyers.

The presence of the Panel and Code additionally has an effect on the UK's propensity to litigate. The presence of the Panel and the Code in the UK both disincentivises and precludes takeover litigation due to a number of reasons: the Panel plays a significant role in solving disputes, and as such provides an efficient alternative to litigation; the Code manages the behaviour of the directors and the respect given to the Panel by the courts means that judges are extremely hesitant to play a role in the regulation of takeovers. The absence of such a



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body as the Panel in the US may also explain why parties to a takeover have to rely heavily on the courts for any resolution of complaints made.

The existence of the Code in the UK, and its creation of an alternative means of disciplining target directors, and of a climate in which allegations of misbehaviour by target directors are expected to be settled through the Code/Panel, are essential elements of the specifically-takeover related culture in the UK. Other elements such as the acceptability of takeover litigation in the US takeover process may be a factor in explaining the disparity. However these cultures have been determined by the structural components of the US and UK system, and therefore these components would be the likely explanation for the increased levels of litigation rather than culture specifically.

Having completed our description, and our explanation, of the UK and US litigation landscapes, we can now address our final question: so what? What consequences flow from these differences, and why should anyone be concerned about them? It is to these matters, to the *evaluation* of the differences in the two landscapes, which our next chapter will turn.



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## Chapter Eight

## Impacts of the Propensity to Litigate

### 8.1 Introduction

In chapter seven, the differences in the takeover litigation landscapes of the UK and US were *explained*. This chapter will now turn from explanation to *evaluation*. In other words, this chapter seeks to *evaluate* the impacts of these differences on the takeover process in each jurisdiction. There are, of course, many impacts that litigation may have, and it is beyond the scope of this thesis to evaluate them all. As such this chapter will limit the impacts discussed to those which significantly affect what generally is sought from the takeover process (i.e. to be quick, not unduly costly, and of benefit to shareholders and society in terms of an effective corporate governance mechanism via the market for corporate control ("MCC")). These three areas of impact are the most significant and also the most easily identifiable. It is therefore more worthwhile to concentrate a more detailed evaluation of just these, rather than seeking to extend the assessment beyond what can realistically be achieved within a single chapter.

Section 8.2 will thus evaluate the impact of the different propensities to litigate on the *speed* in which a takeover can be completed. The abundance of litigation that takes place during a takeover in the US does inevitably have an impact upon the average length of a takeover. Ideally the takeover process is completed quickly in order to prevent occurrences of the tactical use of time, and to avoid disruption to the market. This is the reasoning behind strict completion timetables for takeovers that have been imposed by regulators.

Section 8.3 will evaluate the impact of different propensities to litigate on the *costs* of takeovers, focusing principally on the costs of the Panel and US attorney fees. Due to the average attorney fee costs that arise in almost all takeovers in the US, the cost of solving disputes via litigation is far more costly than the Panel system in the UK. In the US almost every takeover is subject to a claim, and every claim that is settled requires the payment of attorney fees.



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Section 8.4 will evaluate whether litigation, (which will be established does have negative impacts to time and cost), provides any *benefits* for target shareholder in the US. Particularly when compared to the UK regime, which substitutes the Panel for litigation. Whilst the settlements that are achieved from litigation in the US are not economically beneficial to shareholders, they do provide additional disclosures. These disclosures, whilst not having much effect on the shareholder vote, do ensure that the shareholder is fully informed. Litigation is also argued to play a significant role in corporate governance, as it is a mechanism that is used to enforce and protect shareholders rights. Finally, section 8.5, will consider the impact the different propensities to litigate have on the MCC itself. If the MCC, is seen as beneficial then it should not be inhibited. The propensity to litigate in the US can however have constraining effects on the MCC, as will be shown.

## 8.2 Impact on Takeover Speed

Ensuring the speedy completion of takeovers is generally agreed to be highly desirable. This point will be returned to in section 8.2.3, to spell out the advantages of a speedy process. First, 8.2.1 shows both how, in the UK, the Code and the Panel together place great emphasis on adherence to an accelerated timetable for takeovers, and how litigation is not allowed to, and does not, disrupt this timetable. The process in the US will be examined in 8.2.2 and finds that litigation there does indeed introduce considerable delays into the takeover process.

### 8.2.1 Speed of Takeovers in UK

As discussed in chapter three, the Code establishes a 'fairly rigid timetable for the entirety of the bid.'[799] Without the consent of the Panel, an offer cannot remain open longer than 60 days, if the offer is not unconditional as to acceptances.[800] Completion of takeovers in the UK will be no shorter than 74 days, which is the earliest date at which an offer can close; and no longer than 81 days, when all conditions to the offer must be satisfied.[801] Consequently, when an announcement of an offer is made "the clock starts ticking."[802] When approaching a target company, the Code makes it clear that a bidder must not be 'hindered in the conduct of their

[799] Code Rules 30–35; see also chapter three section 2
[800] Code Rule 31.6; see also chapter three section 2
[801] Code Rule 31
[802] Kershaw (n127) 259



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affairs for longer than is reasonable.'[803] This includes the commencement of litigation, by the target company, which would have the effect of frustrating a bid.[804] Moreover, the reluctance of the Panel to allow *any* litigation during a bid demonstrates the significance they place on the ability of takeovers to occur swiftly.[805] This is also reflected in the court's decision to take an "historical approach" to takeover litigation.[806] There is however, very little takeover litigation in the UK, for these and other reasons as discussed in chapter seven. This means that the timetable set for takeover completion is not subject to delays caused by litigation. Any increase in the levels of litigation would therefore severely impact upon this short timetable.

Although there is little litigation, there are still complaints made to the Panel during takeover bids. As such, decisions are frequently made by the Panel, a process which could have the potential to delay the timetable as much as litigation could. The essential characteristics of the Panel's system of flexibility, certainty and speed, nonetheless means that parties to a takeover are 'informed of where they stand under the Code by the Panel in a timely fashion.'[807] The Panel therefore relies on its ability to make decisions informally in order to function efficiently.[808] Armson, who undertook a study evaluating the workings of the Panel, noted that 'as a general rule, [the Panel's] decisions are relayed over the telephone, either immediately or within 24 hours'[809] This is not something a court could reasonably be able to achieve for these types of matters. The informality of the Panel and their ability to respond immediately to complaints allows for bids to move quickly, despite the fact that disputes between parties require resolving. Litigation could not be concluded as quickly.

More formal written rulings by the Panel's Executive cannot be completed as quickly as the more informal decisions (i.e. via the telephone); however the occasions when they are needed are "very rare."[810] The Panel reduces the need for formal decision making by allowing

[803] Code General Principle 6
[804] Code Rule 21
[805] See chapter seven section 4.4; see also Mukwiri (n2)
[806] Datafin (n268); See chapter seven section 4.2; see also Mukwiri (n2)
[807] The Takeover Panel Report on the Year Ended 31 March 2002 <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/report2002.pdf> accessed 10 July 2016
[808] See Emma Armson, 'Models for Takeover Dispute Resolution : Australia and the UK' (2005) 5 Journal of Corporate Law Studies 401.
[809] ibid 421 (Advice from Noel Hinton, Deputy Director General, UK Panel Executive (27 April 2005))
[810] ibid



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consultations with the Executive, which can 'give rulings and interpretations before, during and, where appropriate, after takeovers.'[811] Because the Panel recognises that the decisions it makes are time sensitive, and in order to adhere to the Code's timetable, it also promptly answers enquires about the 'possible effects of the Code' on pending takeovers.[812] As previously discussed in chapter seven, providing guidance is an important part of the Executive's role, and as such, the Panel 'encourages and in some cases requires early consultation so that problems can be avoided.'[813] Again, this is not something that can be easily offered by the courts, and even if they were able to do so, they may feel that the Panel has greater expertise to deal with such guidance.[814]

The Executive can also refer disciplinary matters to the Panel's Hearing Committee, which can "be convened at short notice."[815] This is, however, comparatively rare and most of the matters considered by the Committee are appeals from Executive decisions.[816] The Panel places great emphasis on its ability to make decisions quickly in order to avoid delays to the takeover process in the UK, and has 'long been accustomed to delivering decisions quickly'[817] and eliminating complaints which have no substance.[818] Its function and speed is not something which could be easily emulated by the courts if appeals to decisions were to be made.

### 8.2.2 Speed of Takeovers in US

The Williams Act in the US does not provide for a time limit for takeover bids.[819] The tables below illustrate the average timetable for both a single step-transaction and two-step takeover via a tender offer, which on average take 91 and 109 days to complete respectively.

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[811] Takeover Panel Report (2002) (n807) 7
[812] ibid
[813] ibid
[814] See their stance on not "Stepping on the Toes of the Panel" in chapter seven section 4.2
[815] Takeover Panel Report (2002) (n807) 7
[816] ibid
[817] ibid 9
[818] ibid
[819] Kershaw (n127) 265



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**Table 8.1**

| **Single-Step Transaction** | |
|---|---|
| **Day(s)** | **Activity** |
| 1 | Announcement |
| 2 to 15 | Prepare proxy statement (Target with the Bidder's input) |
| 16 | File preliminary proxy materials with SEC |
| 26 to 50 | Receive and resolve SEC comments |
| 55 | Print and mail proxy materials |
| 90 | Target shareholders' meeting to vote on merger |
| 91 | Complete merger (provided requisite vote is obtained) |
| | *Bidder now controls and owns 100% of Target* |

*Materials taken from 'A Guide to Takeovers in the United States', Clifford Chance Guide (2010)

**Table 8.2**

| **Two-Step Transaction** | |
|---|---|
| **Day(s)** | **Activity** |
| 1 | Announcement |
| 2 to 15 | Prepare Offer to Purchase and Schedule 14D-9 (Target) |
| 15 | Commence tender offer; file definitive tender offer materials with SEC; mail materials to Target Shareholders |
| 15 to 43 | Address any comments provided by SEC staff |
| 43 | Close tender offer (if minimum tender offer and other conditions satisfied) |
| | *Bidder now controls Target* |
| 47 | If Bidder now owns at least 90% of Target's outstanding shares - file short-form merger certificate |
| | *Bidder now owns 100% of Target* |
| 47 to 77 | If Bidder owns less than 90% of Target's outstanding shares - prepare and file proxy materials with SEC relating to "squeeze-out" merger |
| 88 | Mail proxy materials |
| 108 | Target shareholder meeting to vote on 'squeeze out' merger |
| 109 | Complete merger |
| | *Bidder now owns 100% of Target* |

*Materials taken from 'A Guide to Takeovers in the United States', Clifford Chance Guide (2010)



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Unlike the dispute regime constructed by the Panel in the UK which causes little delay to the takeover process, litigation in the US has been shown to cause significant disruptions to the time it takes for bids to complete. This disruption is found in almost all US takeovers.[820] One of the main causes of these delays is the amount of time it takes the court to approve settlements.[821]

| | **Days to completion** |
|---|---:|
| Offers *not* litigated | 93.74 |
| Offers litigated | 148.95 |
| Large deals *not* litigated | 114.01 |
| Large deals litigated | 146.29 |

*data taken from Krishnan et al

Krishnan et al's findings confirmed that litigation tends to delay the completion of deals that are eventually successful, compared to offers that are not litigated.[822] The average time to reach completion, which they defined as the time between the announcement and deal completion dates, was 99.6 days. In all offers not litigated it was 93.74 days as compared to offers which were litigated that took 148.95 days to complete.[823] In large deals not litigated it took 114.01 days for completion compared to 146.29 days in large deals litigated.[824] That is a difference of 55.21 days to completion in all offers and 32.28 days in larger deals between litigated and non-litigated takeovers. They noted that offers that involve litigation 'entail a significantly longer time to completion than offers that do not.'[825]

To summarise: deals that are litigated in the US took on average 88.5 more days to complete than the maximum regulated time for a takeover in the UK, which is 60 days from the announcement to acceptance.[826] Thus, it is clear that the process of takeovers is slower in the

[820] See Cain and Davidoff Solomon (n537); Fish et al (n563); Krishnan et al (n514); Thompson, Thomas (n651)
[821] See Cain and Davidoff Solomon (n537) 5
[822] Krishnan et al (n514) 23-24
[823] ibid Appendi, Table 3
[824] ibid
[825] ibid 48
[826] However, it must be noted that it is less than half this time for deals not litigated in the US, which take 33.74 days longer to complete than in the UK.



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US than in the UK, and it also seems plausible to conclude that the greater propensity to litigate in the US is a significant cause of this difference.

### 8.2.3 The Significance of the Speed of Takeovers

Why does the speed of takeovers matter? Why choose to focus on this impact? A faster takeover process is beneficial for target companies as it will shorten the period of disruption that the company will face. As Kershaw explains, if a 'bid lingers on threatening a possible change of control…this [can] clearly distract management from running the company.'[827] Consequently, day-to-day management of the target company will be negatively impacted by a drawn out takeover attempt; and the more drawn out the takeover process the more impact this disruption will cause. Kershaw however, considers whether the minimum offer time period in the UK is too short for target boards to carry out market checks in order to assess an accurate pricing of the company's shares.[828] A shorter time period might also hinder a target boards' ability to 'identify alternative bidders and encourage them to place their own offer for the target company.'[829] The extended timetable created by litigation in the US could be more beneficial to this practice; however an extension of the UK timetable can be obtained from the Panel. The bottom line however, is that the quicker the takeover, the faster the target company can return to focusing on day-to-day management of the company and progress its own commercial strategy.

A faster takeover process is also beneficial for the bidding company as it is less likely to be deterred from pursuing the bid to completion. Bidders may be more inclined to give up on the bid if too much time has elapsed. Target companies may therefore take advantage of their ability to slow down a bid using litigation in order to defend against a bid. This point may however be moot in the UK as target companies are prohibited from taking this kind of action without the permission of their shareholders,[830] and US target companies have more efficient

[827] Kershaw (n127) 265
[828] ibid 262
[829] ibid
[830] See Code Rule 21



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means of defending against a bid.[831] However, US target shareholder litigation will still draw out the process and may affect the bidder's ability to complete the bid. Furthermore, the same problems that afflict target boards from lengthy takeovers are also faced by bidding companies; takeovers are disruptive and distract from the day-to-day running of the company.

Faster takeovers are also good for target shareholders, as a lengthy takeover process could affect their ability to assess the offer. This is due to the uncertainty that takeovers can create in the assessment of market prices. Nevertheless, the process of a takeover should not be so fast that it has an effect on the shareholders ability to make a decision. Although an unhindered takeover process is preferred shareholders will still need a reasonable time in which to assess the bid. Kershaw notes that 'when shareholders are presented with an offer, any assessment of valuation is necessarily something of an art and not a precise science.'[832] Kershaw notes that there are some investors who do not have the expertise to properly conduct an assessment of an offer quickly and 'may instead sell in to the market place using the market as a mechanism as a free provider for deal advice.'[833] However, as Kershaw also notes, the average investor in the UK and US generally 'tend[s] to be sophisticated and have easy access to expertise to make an informed decision.'[834] He observes that 'sophisticated institutions require little time and have no need for regulatory minimum provisions.'[835] Even though takeovers in the UK are completed to a strict timetable there is enough time for the shareholders to make an "informed decision."[836]

Target shareholders however also need time to obtain the best deal, as target boards will require time 'to engineer a competitive bid process for the company, or to persuade their shareholders to say no.'[837] Again, the US system, in which takeovers take longer to complete, may allow for this process to happen. US target shareholder litigation does not often change the terms of the deal or result in greater premiums. Provisions in the Code, however do allow

[831] For example, they can use other defences such as board structures, poison pills etc; for an examination of US poison pills see John Lowry 'Poison Pills in U.S. Corporations – A Re-examination.' (1992) Journal of Business Law 337
[832] Kershaw (n127) 262
[833] ibid
[834] ibid
[835] ibid
[836] See Code General Principle 2
[837] Kershaw (n127) 262



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for competitive bids to occur and again an extension of the timetable can be sought from the Panel. US target shareholder litigation, however, does produce greater disclosures from the target company. If the slower US process generates more disclosures, shareholders have access to better information than that which can be disclosed in a slower process. The better informed shareholder is better than a less informed shareholder. The delays in speed caused by litigation might therefore be a price worth paying for a better informed shareholder. However the UK generates, through the Code, comparable information to that which is generated through disclosure focused litigation in the US, and does so (in the UK) much faster and with little disruption to the takeover process.[838]

A faster takeover process is better for the market generally. This is because the market can become un-stabilised due to the uncertainty a takeover can create. The share price of the companies involved in a takeover can become warped by rumours of the transaction. The 'target company should not therefore be subject to an offer, or speculation regarding an offer, for an excessive period of time.'[839] This also has an effect on the ability of the target company, target shareholders and bidding company to assess the bid correctly.

The faster the takeover can progress the more the process promotes an efficient market price through the availability of prompt and accurate information. This is because investors will be provided with the information they need from the target board quickly, in order to assess the value of the shares of the target company; rather than the information not being available because the target company is focused on litigation. Timely disclosures will enable both the board and the shareholders to make an informed decision as to whether to purchase the offered securities or whether the target shareholder should sell. This contributes to an efficient capital market, which means that at any given time prices within a market fully reflect available information.[840] Gullifer and Payne note that 'accurate information is necessary to ensure that money moves to those who can use it most effectively and that investors make optimal choices about their investment decisions.'[841] Both the bidding

[838] This point will be returned to in section 8.4 of this chapter.
[839] Payne (n143) 90
[840] See Fama (n52)
[841] Gullifer, Payne (n130) 455



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company and target shareholders are investors and need to be well informed with up to date information.

A takeover which is unnecessarily drawn out can obviously affect the certainty of information. Without 'adequate information investors will not be able to distinguish bad investments from the good.'[842] A false market could therefore be created. In the US, this is more likely to be a problem due to the delays litigation can cause to the takeover process. The Code however recognises this issue, and is the basis for the speedy timetable.[843]

## 8.3 Impact on Costs of Takeovers

As well as ensuring the speedy completion of takeovers, it is the (popular) consensus that takeovers should not be unduly costly.[844] The propensity to litigate will inevitably affect the level of costs involved in completing a takeover. Why exactly costs matter will be discussed in 8.3.4. Prior to this, 8.3.1 demonstrates that the litigation costs of the UK system are relatively negligible and do not therefore increase the overall costs of UK takeovers. This is the case even when comparing operational costs of the Panel. Section 8.3.2 demonstrates that in comparison to the UK the cost of litigation in the US does impact upon the overall level of takeover costs. The aggregate distribution of costs will also be compared in 8.3.3 in order to show that, not only are the levels of costs different, but that they also impact different takeover participants.

### 8.3.1 UK Costs

As noted above, the costs of takeover litigation in the UK are almost negligible, given how little occurs. In light of the finding (in chapter seven), that the existence and operation of the Panel is one of the reasons for the absence of UK litigation, the costs which the Panel regime generates need to be compared to the litigation costs in the US. In assessing these (UK) costs, they will be broken down into two groups. The first concerns the fees which companies must pay to the Panel in order to enjoy the benefit of the Panel's oversight of takeovers. The Panel

[842] Gullifer, Payne (n130) 455
[843] See Code General Principle 2
[844] It must be noted that the discussion of costs in this section relates only to the cost of litigation or the cost of dealing with complaints via the Panel, and not other factors that may impact the levels of costs in each system.



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derives its funding from three principal sources of income: document charges, a PTM Levy and Exempt/recognised intermediary status charges, and these are examined in 8.3.1.1-8.3.1.3 below.[845] The second group of UK costs concerns the fees UK companies pay their own lawyers; companies will still need lawyers to advise them on, and deal with, Code complaints, even if they are not paying lawyers to litigate.

8.3.1.1 Panel Document Charges

Charges are payable on offer documents valued at £1 million or more.[846] The amount of the charge will depend upon the value of the offer according to the scale set out below.[847]

**Figure 8.1**

| Value of the offer £ million | Charge £ | Charge as a maximum % of the value of the offer |
|---|---|---|
| 1 to 5 | 2,000 | 0.20% |
| Over 5 to 10 | 8,500 | 0.17% |
| Over 10 to 25 | 14,000 | 0.14% |
| Over 25 to 50 | 27,500 | 0.11% |
| Over 50 to 100 | 50,000 | 0.10% |
| Over 100 to 250 | 75,000 | 0.075% |
| Over 250 to 500 | 100,000 | 0.04% |
| Over 500 to 1,000 | 125,000 | 0.025% |
| Over 1,000 to 2,500 | 175,000 | 0.0175% |
| Over 2,500 to 5,000 | 250,000 | 0.01% |
| Over 5,000 | 350,000 | 0.007% |

[845] Fees and Charges, The Takeover Panel <http://www.thetakeoverpanel.org.uk/the-code/fees-and-charges> accessed 06 July 2016
[846] The document charges are subject to periodic review; See Fees and Charges ibid
[847] ibid (the Panel also explains on their website that, where a firm offer is announced pursuant to Rule 2.7, but no offer document is published, one half of the document charge that would have been payable, calculated on the basis of the offer value at the time of the announcement of the firm offer or of any revised offer, is payable.)



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8.3.1.2 Panel PTM Levy

The Panel also derives a large part of its income from a charge on 'certain trades in the securities of companies whose shareholders benefit from the protections afforded by the Code' (this is called the "PTM Levy").[848] The current levy rate is one pound per contract 'where the total consideration of the relevant trade is greater than £10,000 (or the equivalent in any other currency).'[849] The PTM Levy is payable on trades in, equity share capital, whether voting or non-voting.[850] The PTM Levy is not however payable on trades in covered warrants; debentures and other debt securities; preference shares; Permanent Interest Bearing Securities; contracts for differences and total return swaps; spread bets; or option contracts.[851] The PTM Levy is also not payable on trades in securities of open-ended investment companies, including exchange traded funds.[852] The Panel's website clarifies that the PTM Levy is payable on both the purchase and sale of securities, and is payable by the purchaser or seller.[853] An intermediary will collect the Levy, who is usually a member of a regulated market or a multilateral trading facility that requires its members to collect the PTM Levy.[854]

8.3.1.3 Panel Exempt Status Charges

Certain organisations are, however, exempt from paying these charges, but they are still required to pay an exemption charge. An exempt status can be obtained by fund managers and market makers if they can 'demonstrate to the Panel's satisfaction their independence

[848] Takeover Panel Fees and Charges (n845)
[849] ibid
[850] ibid (the Panel notes that for these purposes, equity share capital is share capital that has an unlimited right to participate in the profits of the company; securities convertible into equity share capital; transferable securities that give the holder the right to subscribe for equity share capital, including warrants, provisional allotment letters and nil paid rights; and American Depository Receipts and Global Depository Receipts in respect of any of the securities described above.)
[851] ibid (Fees are not payable on option contracts if they are securities which are convertible into, or which will give the holder the right to subscribe for, equity share capital. However, the exercise of an option contract would be a trade on which the PTM Levy is payable.)
[852] As defined in Article 1(2) of the Directive on Takeover Bids (n152)
[853] Fees and Charges, The Takeover Panel (n845)
[854] ibid (The Panel stipulates that the PTM Levy will be charged when more than one security is included in the same trade, but it will be charged as if there has been a separate trade in each security. A PTM Levy will also be charged where orders from different clients are combined into one trade, but it will be charged as if there has been a separate trade for each client. The PTM Levy is not payable on "trades between members of regulated markets or multilateral trading facilities when they trade as principals between themselves." The PTM Levy is also not payable on placings of new securities or on securities borrowing or lending transactions.)



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from corporate advisory and corporate broking operations.'[855] The Panel explains that the purpose of granting exempt status is to:

> *'remove them from the presumption of concertedness which would otherwise apply and to enable the relevant group's normal trading and fund management activities to continue without Code consequences for the group's corporate finance clients, and without the Code being breached, when they are involved in offers.'*[856]

A payment of £6,000 per exempt entity is required to be paid to the Panel for taking advantage of an exempt status.[857] This is because of the cost that is borne by the Panel in granting and maintaining exempt statuses.[858]

8.3.1.4 Costs Relating to Panel Complaints and Breaches of the Code

Lawyers' fees for dealing with Panel complaints are small. This was confirmed by the lawyers who took part in the interviews for this research. One lawyer explained, 'in general, for most deals the costs of dealing with the Panel would be very low. There are occasional cases, particularly in hostile or competitive bids where the time and cost can be more significant but these tend to be the exception.'[859] As such, there does not seem to be large fees that companies in the UK must pay to lawyers' for advice on how to navigate Panel complaints. The cost is therefore primarily made up of charges that are paid towards the running of the Panel.

[855] The Panel on Takeovers and Mergers, 'Market-Related Issues: Revision Proposals Relating to Various Rules of the Takeover Code and the SA' (Consultation Paper PCP2004/3, 17 June 2004) para 1.6; (The Panel also carries out periodic reviews of all groups which benefit from exempt status, either in respect of their fund management or principal trading operations. The former are reviewed on a bi-annual basis and the latter on an annual basis.)
[856] ibid
[857] Fees and Charges, The Takeover Panel (n845)
[858] ibid
[859] See appendix two



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### 8.3.2 Costs of US Litigation

It is ordinarily the rule in the US that parties involved in litigation cover their own costs.[860] In shareholder litigation, however, there is a long-recognised exception to this rule.[861] The exception is based on the principle that if a "corporate benefit" can be shown then the claimant shareholders will have their litigation costs paid by the defendant company.[862] A corporate benefit is determined by the courts by assessing whether the settlement that has been reached by the parties confers a benefit to the shareholders.[863] How this is assessed was discussed in greater detail in the previous chapter.[864] Courts do, however, generally conclude that settlements confer a benefit to shareholders, even if the settlement is 'disclosure only.' Consequently the cost of litigation in the US is generally borne by defendant target companies.

Cain and Davidoff Solomon found that 71.6 percent of takeover litigation in the US resulted in some kind of settlement.[865] Of these settlements they found that 55.1 percent settled for additional disclosures.[866] They recorded that the average attorneys' fees from these disclosure only settlements was $749,000 from the period of 2005 to 2011; and that they were 'considerably lower than other settlement types.'[867] Fisch et al have however reported that the average requested fee award for these settlements has been declining over the past several years, from an average of $730,000 in 2009 to an average of $540,000 in 2012.[868] New studies also show that the average fee awarded in disclosure only settlements was approximately $361,000 in 2015.[869] Despite this in 55 percent of the litigation undertaken by target shareholders where only additional disclosures were released, the target company would have paid an average of nearly half a million dollars for the shareholders' lawyers'

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[860] Chrysler Corp v Dann 223 A2d 384 386 (Delaware 1966); see also James D Cox, Randall S Thomas, 'Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the U.S. Securities Law' (2009) Vanderbilt University Law School Law & Economics, Research Paper No 09-10, fn 1

[861] Dover Historical Soc Inc v City of Dover Planning Comm 902 A2d 1084 1090 (Delaware 2006); see also Sean J Griffith, 'Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees' (2015) 56 Boston College Law Review 37

[862] ibid

[863] ibid; see also Sugarland (n673) [149-50]

[864] See section 3.2.1

[865] Cain and Davidoff Solomon (n517) 16

[866] ibid

[867] ibid

[868] Fisch et al (n563) 568

[869] See Cain and Davidoff Solomon (n537)



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fees over the past decade. In approximately 20 percent of the litigation, the fees would have been considerably higher in order to take into consideration the greater "corporate benefit" given to shareholders in more favourable settlements. The cost of takeover litigation in the US therefore has a significant impact upon target companies.

### 8.3.3 Distribution of Litigation Costs in UK and US

It is clear that the US system is far more costly when comparing the aggregate costs of the UK system (in which complaints are solved using the Panel) and that of the US system (which uses the courts to settle litigation). The charges which are required to be paid to the Panel for offer documents and lawyers advice on navigating the Panel's complaints system, is considerably less than the average attorney fee for a disclosure award in the US. The average attorney fee award costs nearly four times more than the cost of complying with the Panel fees in the UK.[870] For example, £75,000 is the document charge that is to be paid to the Panel when a formal offer has been made for a transaction valued at £100 million, which is 0.075 percent of its value. In the US $361,000 was the average attorney fee award for a disclosure settlement in 2015.[871] This equates to 0.36 percent of the value (when taken at the lower value limit of the takeovers collated by Cain and Davidoff Solomon at $100 million). The highest Panel charge in the UK is £350,000 for a transaction valued over £5,000 million, which equates to 0.007 percent of the value. Lawyers' fees for dealing with Panel complaints are also low and not comparable to US attorney fees. Not only are the Panel charges less expensive than incurring litigation costs, they are also fixed, which brings certainty to the cost of each transaction.

The distribution of the costs in the UK and US system are also different. The UK system is more of a generally shared burden, with fewer of the costs being borne specifically by those involved in takeovers, or even by those raising complaints (i.e. the equivalent of 'litigating before the Panel'). As such, in the UK, most of the costs of running the system are shared out amongst all companies, and little of them are borne specifically by litigating takeover

[870] £75,000 exchanges to $92,407 (at an exchange rate of 1.23 dollars to the pound – 05 January 17); 361,000/92407 = 3.90
[871] See Cain and Davidoff Solomon (n537)



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participants. In US they are borne initially by the target company, and perhaps eventually by the target shareholders.

Cox and Thomas argue that the cost of litigation is not just borne by the target company, but also by target shareholders.[872] Their argument is based on the circulatory theory, which states that when litigation costs are paid by the target company it will be at the expense of those shareholders who continue to hold shares in that company after the litigation has settled.[873] This also greatly affects shareholders who have diversified investment portfolios.[874] The payment of both the target shareholders and target company's litigation fees will lead to an overall net loss to the target shareholders.[875] They observed, as such, there is a general negative perception of securities class actions in the US.[876] Litigation consequently, 'yield[s] small, if any, real gains to investors with the true economic benefits going to the class' counsel.'[877]

As the cost of shareholder litigation is shouldered by the target company, this type of litigation does not increase the total cost of the takeover for the bidder (in a small number of cases, however, the litigation may have the effect of increasing the premium offered). The bidder is therefore not at risk of being burdened with these costs, and won't therefore be deterred from making an offer and completing the bid on this basis.[878] As almost every takeover is subject to litigation in the US, and every claim that is settled requires the payment of attorney fees, Haims and Beha consider that the payment of these fees have 'essentially become a tax on significant mergers and acquisitions.'[879] Consequently, the distribution of costs may not have a significant effect on the takeover process if it is expected and budgeted for by the target company (and target shareholders) as something that they will have to pay. The distribution of costs in the UK however is preferable as lower costs are distributed

[872] Cox, Thomas (n860)
[873] ibid 13
[874] ibid 16-17
[875] ibid
[876] ibid 11
[877] ibid
[878] If the takeover is successful, the bidder and the bidder's shareholders may ultimately be affected by the cost of the shareholder litigation.
[879] Joel C Haims, James J Beha II 'Recent Decisions Show Courts Closely Scrutinizing Fee Awards in M&A Litigation Settlements' <www.mofo.com/files/Uploads/Images/130418-In-the-courts.pdf > accessed 20 October 2016



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equally among all companies who benefit from the Panel's successful regulation of the takeover process and expertise if, and when, it is needed.

### 8.3.4 The Significance of the Cost of Takeovers

The level of the overall cost of takeovers is important to the parties involved. Obviously, all parties would prefer that "dead weight loss" was reduced. This is because money could be better spent elsewhere; for example towards a premium for the shareholders or towards the costs of creating synergies between the two companies once the takeover has been completed. High levels of costs may also deter takeovers from taking place at all. This point will be returned to later in section 8.5.

## 8.4 Impact of Litigation on US Target Shareholders

The sections above established that the level of litigation in the US impacts upon both the time it takes for takeovers to complete, and the aggregate and distributional costs. These impacts are increasingly significant when compared with the same impacts of the UK regime. The benefits that US target shareholders gain from litigation may however offset the negative impacts of an extended timetable and increased costs. These benefits are monetary awards, amendments to the deal terms and additional disclosures. However, monetary awards and amendments that provide meaningful benefits to shareholders only occur in a small percentage of cases, and additional disclosures are argued to have little effect on how shareholders vote. The increased disclosures are contended to have created a well-informed shareholder, and the level of litigation that has been commenced has had a positive effect on the overall quality of disclosures received by shareholders from the target board. Yet, these benefits are not better than those obtained by target shareholders in the UK under the Code and the Panel.

### 8.4.1 Do US Target Shareholders Achieve Better Settlements from Litigation?

As previously established, US shareholder takeover litigation often results in a settlement deal. These settlements are beneficial to shareholders, and they do achieve results that they



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would not necessarily have gotten had they not litigated, particularly if money or an amendment to the deal terms is awarded. Settlements however rarely provide any significant economic benefit. Nevertheless, settlements in the US do provide greater disclosures to target shareholders from their board of directors. These disclosures are not, however, any greater than those that target shareholders in the UK would obtain under the supervision of the Panel. This section will now examine these points in turn.

In their study, Cain and Davidoff Solomon found that the most common type of amendment settlement in the US was a reduction to the termination fee. Other terms that were varied included, 'post-sale closing limitations, extended appraisal periods and modification or elimination of voting arrangements.'[880] These types of settlements can be quite advantageous for target shareholders as they 'often provided more economic opportunity to shareholders, such as providing a longer period for them to exercise appraisal rights.'[881] The higher value of such settlements is also illustrated by the increase in the average attorney fee awards. For example, $1.76 million was awarded on average for an amendment settlement as compared to $500,000 for a disclosure only settlement.[882]

Cain and Davidoff Solomon however found that amendment settlements, that involve a change to the deal's transaction terms, only occur in 0.2 percent of settlements: 10 percent of these settlements are both amendment settlements and disclosure settlements.[883] In Daines and Koumrian's study, of the 119 settling takeover lawsuits they recorded only 67 resulted in a "unique settlement."[884] Of the 67 settlements, they found that 'shareholders received supplemental disclosures (and nothing else) in 54 settlements, or 81% of cases.' In four of the cases settled the deal termination fee was reduced and the parties reached agreements about appraisal rights in six cases.[885] There was only one settlement that was found to have increased the merger price.[886]

[880] Cain and Davidoff Solomon (n517) 17
[881] ibid
[882] ibid
[883] ibid
[884] Daines and Koumrian (n526) 6
[885] ibid
[886] ibid



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Fisch et al found that although deal litigation is "pervasive," shareholder litigation 'rarely result[ed] in a monetary recovery for the plaintiff class.'[887] Instead, they found that the vast majority ended in a disclosure settlement or dismissal.[888] They noted that:

*'compensation for the benefit produced by these settlements—often worth no more, in the words of a famous jurist, than a "peppercorn"—plaintiffs' attorneys receive a fee award social desirability of affirming an important principle that underlies the right vindicated.'*[889]

Only 4.8 percent of transactions were recorded by Cain and Davidoff Solomon to provide a monetary benefit to shareholders that could be classified as a consideration increase.[890] They noted that consideration increases have a wide distribution with an average increase of $70 million in aggregate but a standard deviation of $152.8 million.[891] The minimum consideration increase in their sample was one million dollars and the maximum was recorded as $669.8 million.[892] They defined consideration increases as settlements which provide 'quantifiable benefits to shareholders' and as such 'pay the most in attorneys' fees,' averaging $9.2 million.[893]

In their study, however, Krishnan et al found that on balance, there was a significant economic effect of takeover litigation in the US. Their study established that there was a nine percent increase, in the takeover premiums they recorded after controlling for other offer features.[894] They concluded that litigation causes, or helps to cause, increased bid premiums. This occurred, they explained, because bidders often responded to target shareholder claims that an initial offer was too low by generally raising their bids.[895] If a bid was not increased then there was increased probability that the deal would fail.[896] US target shareholder litigation may therefore deliver greater bid premiums than UK target shareholders could achieve without litigation. However the lower costs and faster speed of takeovers in the UK

[887] Fisch et al (n563) 559
[888] ibid
[889] ibid
[890] Cain and Davidoff Solomon (n517) 17
[891] ibid
[892] ibid
[893] ibid
[894] Thompson, Thomas (n651) 75
[895] ibid
[896] Krishnan et al (n514) 47-48



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may offset the loss of the greater bid premiums achieved by target shareholders in the US. That is, if indeed, there are greater premiums paid.

### 8.4.2 Do US Target Shareholders Obtain Better Disclosures from Litigation?

The main benefit achieved by US target shareholder litigation is increased disclosures. It is not quite clear however whether these additional disclosures, gained via litigation, are in fact beneficial to the target shareholders' or whether they are of little value. If they are of value, are they better than the disclosures UK target shareholders obtain under the Code and supervision of the Panel? This section establishes, that whilst the majority of additional disclosures obtained via litigation are individually not valuable (as they do not affect the shareholder vote), as a whole, litigation has motivated directors to disclose better and more valuable information than had been previously disclosed in past decades. This has led to a more informed shareholder in the US, which is important considering the power directors have to influence the outcome of a takeover. However these additional disclosures are not greater than those acquired by UK target shareholders, and as such they are not missing out on benefits that could be achieved by litigating.

Fisch et al considered whether litigation which 'returns no monetary recovery to the plaintiff class must be without merit.'[897] They observed that:

> *'The dynamic, in which every deal is challenged but only the lawyers get paid, has led to widespread scepticism concerning the value of public company merger litigation among both academic and professional commentators.'*[898]

However, they deliberated whether 'equating merit and monetary recovery implicitly dismisses the value of nonpecuniary relief' but noted that it is very difficult to place value on such relief.[899]

[897] Fisch et al (n563) 560
[898] ibid 559
[899] ibid 560



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Fisch et al consequently proposed that the value of nonpecuniary relief in merger settlements should not be measured on settlements and monetary awards alone, but instead be measured by its effect on shareholder voting.[900] Their core hypothesis was as follows:

*'[B]ecause amendments should improve the terms of the merger or the quality of the procedures used in reaching a final agreement, amendment settlements should increase shareholder voting in favour of the merger. In contrast, because forced disclosures should produce negative information about the merger, we hypothesised that disclosure-only settlements should decrease shareholder voting in favour of the merger…Because the purpose of merger disclosure is to inform shareholder voting, it is reasonable to view supplemental disclosure as meaningful if it changes the way reasonable shareholders vote.'*[901]

The disclosure of negative information is particularly relevant when considering the type of disclosure that would be obtained from litigation. This, they explained, is because the defendant company, without "the prod" of shareholder litigation, already has an incentive to disclose positive information in order to 'win approval of the transaction and minimise dissent.'[902] By putting these two hypotheses together, Fisch et al concluded that for supplemental disclosures to be meaningful, they must have a negative impact on shareholder voting in favour of the merger.[903]

Their empirical tests drew upon a hand-collected sample of 453 mergers involving publicly traded target companies announced from 2005 and completed through 2012, along with proxy-voting statistics provided to them by Institutional Shareholder Services (ISS) over the same period.[904] At the end of their study they found "weak support" for their first hypothesis, that amendment settlements increase shareholder voting in favour of a transaction.[905] More importantly, they found that disclosure only settlements did not 'appear to affect shareholder

[900] Fisch et al (n563)
[901] ibid 561
[902] ibid 575; see also See Frank H Easterbrook, Daniel R Fischel 'Mandatory Disclosure and the Protection of Investors' (1984) 70 Virginia Law Review 669
[903] ibid 576
[904] ibid 561
[905] ibid



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voting in any way.'[906] They additionally found weak evidence that consideration-increase settlements increase shareholder voting in favour of a transaction.[907]

The implications of their findings were clear: 'If disclosure settlements do not affect shareholder voting, it is difficult to argue that they benefit shareholders.'[908] Consequently, they argued that the 'illusory benefit of supplemental disclosure must be weighed against the clear cost of merger litigation, including litigation expense as well as delay and uncertainty.'[909] They reasoned that the lack of a significant relationship between disclosure only settlements and shareholder voting, suggested that shareholders may not actually value the additional information from these disclosures 'at least in a way that affects their vote.'[910] They concluded that if additional disclosures gained from litigation do not affect the shareholder vote, it is 'difficult to see how shareholders benefit from it.'[911] Badawi et al's findings also support this conclusion.[912] Their study also examined litigation undertaken by shareholders during a takeover, and found that disclosures resulting from this type of litigation were 'unlikely to provide new information to the market.'[913]

The Delaware court has also recognised that the additional disclosures may not affect how shareholders decide to vote, and that this type of target shareholder litigation 'nit-picks otherwise good disclosures.'[914] In re Clarient Inc. the court stated that the claim was "paradoxical" because at the time of class certification, to proceed with the claim,

[906] Fisch et al (n563) 561
[907] ibid (To measure the significance of their findings, they also tested the effect of other variables on shareholder voting, including transaction size and the premium paid, the proxy advisors' recommendation and institutional ownership, and the jurisdiction of settlement. They did find that the transaction value and the proxy advisors' recommendation did have a significant effect on shareholder voting and that the other variables did not.)
[908] ibid
[909] ibid
[910] ibid
[911] ibid 589
[912] Adam B Badawi, Daniel L Chen, 'The Shareholder Wealth Effects of Delaware Corporate Litigation' (2015) Toulouse School of Economics Working Paper TSE-683 <https://www.tse-fr.eu/sites/default/files/TSE/documents/doc/wp/2016/wp_tse_683.pdf> accessed 08 August 2016
[913] ibid 3
[914] See Transcript of Settlement Hearing, Masucci v Fibernet Telecom Group Inc CA 4680-VCS (Delaware Chancery November 25 2009) at 21 (observing that 'it does worry me that there seems to be a repeated pattern of essentially hidden hope disclosure claims, where we're going to nitpick disclosures which, frankly, if you compare the quality and substance of the disclosures that are given today to those given even ten years ago, there's no comparison').



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shareholders' had 'already decided to take the money in the deal they have already challenged."[915] In re Monogram Biosciences Inc. the court commented that 'there appears to be a trend of litigation being brought more for the sake of litigation being brought than because any plaintiff genuinely believes that the terms of the transaction are actually unfair.'[916] Despite this, the court decided that they would not "quibble with the fee" that had been agreed between the parties for the plaintiff's lawyers.

Under Delaware law, as under federal law, the test for whether additional disclosures should be granted is where there is

*'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'*[917]

Judge Travis Laster argues that full disclosure is part of the procedural fairness the courts are trying to achieve, and the fact that shareholders have approved a transaction after receiving the additional disclosures is "powerful evidence of substantive fairness."[918] He contends that 'moving beyond statutory validity to questions of fiduciary fairness, the fully informed shareholder vote continues to play a central role.'[919] He explains that the Delaware court uses a standard of review to measure whether directors have complied with the standards of conduct imposed by their obligations under their fiduciary duties.[920] The Court of Chancery precedents indicate that 'when a transaction otherwise would be subject to enhanced scrutiny, a fully informed, disinterested stockholder vote alone is sufficient to lower the standard of review to the business judgment rule.'[921] As such, additional disclosures play a key role in assuring shareholders are fully informed and that mergers and acquisitions are not overly

[915] Transcript of Settlement Hearing, In re Clarient Inc Shareholders Litigation CA No 5932-CS (Delaware Chancery August 2 2011) [67]
[916] Transcript of Settlement Hearing, In re Monogram Biosciences Inc Shareholders Litigation CA No 4703-CC (Delaware Chancery January 26 2010) [14] ('[h]onestly, it's not the kind of litigation that is particularly edifying. It doesn't seem to be inspired, as much as it should be, or perhaps at all, by the economic motivations of stockholders or the class.')
[917] Rosenblatt v Getty Oil Co (n419) (quoting TSC Indus 426 US [449])
[918] J Travis Laster, 'A Milder Prescription For The Peppercorn Settlement Problem In Merger Litigation' (2014) 93 Texas Law Review 129, 137
[919] ibid 138
[920] ibid 138-139; see also J Travis Laster, 'The Effect of Stockholder Approval on Enhanced Scrutiny' (2014) 40 William Mitchell Law Review 1443
[921] Laster (n918) 139; see also re Morton's Rest Grp Inc Shareholders Litigation 74 A3d 656 663 n34 (Delaware Chancery 2013)



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scrutinised by the court. Judge Laster further argues that the doctrine of shareholder ratification in the US relies on a fully informed shareholder vote, and the adequacy of the defendants' disclosures is part of the analysis of substantive and procedural fairness.[922]

In describing the two aspects of the unitary entire fairness test, the Delaware Supreme Court stated that the concept of fair dealing 'embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.'[923] When analysing the aspect of fair dealing, the high court reiterated that "[p]art of fair dealing is the obvious duty of candor,"[924] Information may not always be valuable to shareholders, but perhaps it is better and fairer for shareholders to be over informed than not informed.

Sumpter contends that shareholder litigation and disclosure only settlements do ultimately benefit all shareholders. He argues it has a sort of disciplinary affect in that 'companies now provide much better disclosure to their shareholders in relation to mergers and acquisitions.'[925] US litigation may therefore have played a corporate governance role in encouraging greater disclosures from target companies to the shareholders in an attempt to avoid litigation. This may also explain why the quality of additional disclosures has decreased. As target directors have provided better disclosures, claims with lesser merits have been commenced. Lawyers are therefore forced to "nit-pick" because directors are giving fewer reasons for claims to be brought. Chancellor Chandler remarked that companies are disclosing things 'that would have never been in a proxy statement 20 years ago.'[926] Vice Chancellor Strine additionally stated that 'disclosure in this area has gotten increasingly more informative. And that's in part the result of changes at the Securities & Exchange

[922] Laster (n918) 139; Stroud v Grace 606 A2d 75 82 (Delaware 1992); Bershad v Curtiss-Wright Corp 535 A2d 840 846 (Delaware 1987); Smith v Van Gorkom (n375); Weinberger (n430)
[923] Weinberger (n430) [711]
[924] ibid [710]; see also Lynch v Vickers (n573)
[925] Phillip R Sumpter, 'Adjusting Attorney Fee Awards: The Delaware Court of Chancery's Answer to Incentivizing Meritous Disclousre Only Settlements' (2013) 15 University of Pennsylvania Journal Business Law 669, 686; see also Ronald Barusch, Dealpolitik: The Useful Corruption of Shareholder Lawsuits (Wall Street Journal, Jan 2011) <http://blogs.wsj.com/deals/2011/01/13/dealpolitik-the-useful-corruption-of-shareholder-lawsuits/> accessed 13 July 2016 (the concern over litigation substantially improves the decision-making and disclosure by corporations.)
[926] In re Monogram Biosciences (n916) [14]



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Commission and, frankly, decisions of this Court.'[927] Vice Chancellor Laster commented that 'we have made tremendous progress in terms of quality of disclosure that goes out to stockholders. And there is no question that...the plaintiffs' bar...deserve[s] a lot of credit for that.'[928]

Greater disclosures in a semi-strong efficient market are highly desirable, as the more information that is made available the better. This is because greater disclosures allow investors participating in the ideal market to choose among shares that represent the ownership of the company's activities under the clear assumption that the process at any time fully reflects all available information.[929] When prices always fully reflect available information the market becomes "efficient." In an efficient market, production-investment decisions can be made easily and accurately.[930]

Many claims in the US are however meritless and result in disclosures which have no impact upon the shareholders decision to vote. Shareholder litigation in the US has, however, led to greater and better quality disclosures for shareholders. All of which assist the shareholder to make an informed decision. In a small percentage of cases litigation has resulted in an increased offer or a change to the deal terms. Many, however, argue that these benefits do not offset the excessive litigation that is commenced in the US. The Delaware courts have acknowledged the high propensity for shareholders to litigate in takeovers, and the criticisms surrounding attorney fee awards, but have remained in favour of the availability of litigation for shareholders. The crackdown on the level of attorney fees awarded and the greater scrutiny placed on disclosure only settlements by the courts, has however had an impact on the levels of litigation in the US (see chapter seven). Although still at a high level, the falling takeover litigation rates may convince some critics that the litigation is on balance a benefit to shareholders rather than a nuisance. The litigation in the US however does not seem to produce better information or better terms than the use of the Panel produces in the UK.

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[927] Transcript of Settlement Hearing and Rulings of the Court In re Sepracor Inc Shareholders Litigation CA No 4871-VCS (Delaware Chancery May 21 2010) [19]
[928] Transcript of Motion for Class Certification, Settlement and Attorneys' Fees and the Court's Ruling, Becker v Am Commercial Lines Inc CA No 5919-VCL (Delaware Chancery Sept 9 2011) [24]
[929] Fama (n52) 383
[930] ibid



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The Code's disclosure requirements seek to ensure a high degree of transparency between the target directors and target shareholders.[931] As noted in chapter three, Rule 23.1 of the Code states that target shareholders must be given sufficient information and advice to enable them to reach a properly informed decision as to the merits or demerits of an offer.[932] No relevant information should be withheld.[933] The Code also states that the target board must prepare a circular that sets out the opinion of the board on the offer (including information from the target board as to any alternative offers) and the reasons for forming its opinion must also be given to the shareholders.[934] The circular must additionally include the target boards' views on: (i) the effects of implementation of the offer on all the company's interests, including, specifically, employment; and (ii) the offeror's strategic plans for the offeree company and their likely repercussions on employment and the locations of the offeree company's places of business.[935] Furthermore, the circular must include the substance of the advice given to the target board by the independent adviser appointed,[936] and a description of any known significant change in the financial or trading position of the target company which has occurred since the end of the last financial period.[937] In addition to this, the circular should also include interests and dealings of the target directors', and give details of any service contracts the directors may have.[938]

### 8.4.3 Agency Problems and Corporate Governance

As touched upon above, shareholder takeover litigation plays an important role as a corporate governance mechanism in the US. Litigation's role is essential due to the power directors have in controlling the outcome of the takeover.[939] The Delaware courts allow the target's board of directors a 'substantial gatekeeping role in unsolicited tender offers, which again is attributable to the courts' recognition of the importance of preserving the board's authority.'[940] Shareholders are given more limited powers, 'essentially the right to sell their shares, to vote

[931] The Takeover Panel 'Extending the Code's Disclosure Regime' (PCP 2009/1 8 May 2009) at para 1.4
[932] Code Rule 23.1
[933] ibid
[934] Code Rule 25.1
[935] Code Rule 25.2 (a)
[936] Code Rule 25.2 (b)
[937] Code Rule 25.3
[938] Code Rule 25.4-25.5
[939] i.e. they can use anti-takeover measures without first obtaining the consent of the shareholders
[940] Bainbridge (n302) 198



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with their shares and to sue to enforce their legal rights under state law.'[941] As highlighted by Thompson and Thomas, whilst shareholder voting has proved to be a relatively weak check on managerial actions, shareholder litigation in state courts has historically played a key role in checking potential, or remedying actual, managerial abuses.[942] The role that litigation plays as a corporate governance tool in the US is not necessary for UK target shareholders. This is because the Code places great emphasis on the protection of shareholders rights and as such promotes shareholder primacy.

As Thompson and Thomas explain management entrenchment is a serious risk posed by hostile takeovers in the US.[943] In friendly takeovers, however, there is the 'constant fear that management may sell the firm too cheaply in order to obtain lucrative severance packages or employment contracts with the bidder.'[944] If the bidder is a controlling shareholder, there will be a conflict of interest between the directors' duty to 'get the best deal for the shareholders and their own self-interest (or that of the controlling shareholder) to implement terms that minimise what the insiders will have to pay to gain control of the remaining interests in the company.'[945] This greater risk of such agency problems, which are unique to takeovers, was the motivation behind the enhanced scrutiny of directors' decisions and the additional duties imposed in the US under Unocal and Revlon.[946] Shareholder takeover litigation is consequently an important tool that can be used to make management accountable and enhance transparency during a takeover. Shareholder takeover litigation 'polices those management self-dealing transactions with the highest potential for self-dealing,'[947] and as such 'has a positive management agency cost reducing effect that may offset the litigation agency costs that accompany them.'[948]

[941] Thompson, Thomas (n651) 12; see also Robert B Thompson, 'Pre-emption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell and Sue' (1999) 62 Law & Contemporary Problems 215, 230-31
[942] Thompson, Thomas (n651) 42
[943] ibid 44
[944] ibid
[945] ibid
[946] Unocal (n443); Revlon (n444)
[947] Thompson, Thomas (n651) 8
[948] ibid 2



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Cox and Thomas note that 'private suits, to the extent they generally stimulate greater compliance, are themselves producing a social benefit.'[949] Corporate governance structures are encouraged to be strengthened in order to avoid wrongdoing that could lead to litigation.[950] As such in a situation in which there is the greatest potential for self-dealing, i.e. a takeover, there is also a real threat of litigation which motivates directors to act in the best interests of the shareholders; at a time when they have all the power to prevent the change in control, so long as they conduct a reasonable investigation in to the share price before defending against the offer.[951] Hence, there is certainly an argument that shareholder litigation is "accorded an important stopgap role" in takeover corporate law in the US.[952]

A critique of this position is that shareholder litigation which is brought during a takeover is not of much benefit, other than supplying further disclosures. As considered above, however, the requirement for greater disclosures (whether produced via actual litigation or the threat thereof) gives greater transparency behind the directors decisions to either approve or dismiss a takeover. Even what is considered to be a "rare"[953] outcome such as an increase in premium or changes to the terms of the deal of the takeover is extremely beneficial to shareholders; outcomes, which would not have been achieved without the shareholders ability to commence takeover litigation. This achieves a corporate governance benefit; to ensure that the takeover process is completed fairly and the best results are realised for the shareholders.

A further critique is that the barrage of shareholder litigation, and payment of attorney fees, is too costly to justify the corporate governance benefits that are achieved. Thompson and Thomas nevertheless argue that 'the small settlements for shareholders, the large attorneys' fees and the frequent nuisance settlements do not paint a true picture of shareholder takeover litigation.'[954] In their data set, they noted that they found settlements that are larger than in the other forms of representative litigation and attorneys' fees that are a smaller percentage of

[949] Cox, Thomas (n860) 13
[950] ibid
[951] See Airgas (n484)
[952] Roberta Romano, 'The Shareholder Suit: Litigation without Foundation?' (1991) 7 Journal of Law, Economics & Organization 55, 55
[953] Although rare in the US, the levels of takeover litigation which achieve these outcomes are still significantly greater than the takeover litigation in the UK.
[954] Thomas, Thompson (n651) 75



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the amount recovered.[955] Shareholder litigation, they noted, 'has often been cast in the role of the evil step sister of modern corporate governance: worthless and expensive to keep around.'[956] However, based on the empirical evidence they concluded that 'the acquisition-oriented shareholder class actions filed in Delaware add value, even if they also have costs.'[957] They further stated that, 'the merits of litigation do make a difference, and that shareholder litigation deserves a seat at the table of corporate governance.'[958] However they argue that 'none of these findings disturb the basic reality that the net value of shareholder litigation will always depend on the balance between the benefits that come for its constraining management agency problems and the offsetting possibility that the representative litigation will spawn its own litigation agency costs.'[959]

McConvill draws on work in behavioural economics, psychology, and sociology to argue that managers have substantial incentives to behave in ways consistent with shareholder interests despite the principal-agent conflict inherent in corporate governance.[960] Castanias and Helfat have also argued that even in takeovers, 'the incentives for superior senior managers to act efficiently prevent the presumed conflict between shareholder and managerial interests.'[961] Romano notes one such potential social benefit from shareholder litigation:

> *'all firms benefit from a judicial decision clarifying the scope of permissible conduct. The benefit of clarification is not simply deterrence of future managerial misconduct, but rather, given the contractual setting of the corporation, identification of a rule around which the parties (managers and shareholders) can transact. As few suits produce a legal rule this explanation of lawsuit efficacy turns on the need for a large number of lawsuits in order to obtain a ruling.'*[962]

The Delaware courts have developed such specific expertise that can be accredited to the volume of takeover cases which they have deliberated over. Consequently, policy regarding

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[955] Thompson and Thomas (n651) 75
[956] ibid 74-75
[957] ibid
[958] ibid
[959] ibid
[960] James McConvill, *The False Promise of Pay for Performance: Embracing a Positive Model of the Company Executive* (Sandstone Academic Press, July 2005) 42-51
[961] Richard P Castanias, Constance E Helfat, 'Managerial and Windfall Rents in the Market for Corporate Control' (1992) 18 Journal of Economic Behaviour & Organization 153 155
[962] ibid 85



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the level of disclosure required in a takeover has been developed and clarified by the courts. This is reflected in the increased quality of disclosures received by shareholders.

Shareholder takeover litigation may be an important tool in protecting the rights of shareholders in the US, and thereby playing an important role in corporate governance. The impact of low levels of litigation in the UK is not, however, a sign that there are failings in the UK system. This is, as said before, because the Code protects the shareholders rights to information regarding the bid and also prioritises the need for shareholders to be the sole decision makers in the outcome of a takeover. If the Code has been breached, the rules will be enforced for them by the Panel. This is in complete contrast to the US, in which the directors are the gatekeepers, and ultimately the success of the takeover will depend on their actions. Any breach of their duties as directors is left to the target shareholders to enforce themselves. Shareholder litigation in the US reduces managerial discretion, which is not present in the UK where only shareholders decide on the merits of the takeover offer. The lack of the propensity to litigate does not have a negative impact on corporate governance because the Code and the Panel effectively regulate the potential for managerial self-dealing.

The need for litigation in the US to enforce shareholders rights also arises from the way in which takeovers occur. The methods in which takeovers are completed in the UK provide further protection to the rights of shareholders. For example, in the UK if an offer is made, shareholders will decide to sell or not; if a scheme of arrangement is proposed, the shareholders vote and that vote is then scrutinised by the courts to ensure that shareholders rights are protected.[963] In the US most takeovers are structured as mergers, using the single-step system. This is often proposed by the target directors and requires their approval. The success of the merger is dependent on a shareholder vote, however to become binding the merger does not need court approval and therefore this vote is not examined by the court.[964] If a hostile takeover offer is made, the target directors may easily defend against it. Accordingly, in the US system shareholders become reliant on the good behaviour of directors, which is subject to the increased risk of the agency problems that arise in the

[963] See chapter two
[964] See chapter four



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specific circumstances of takeovers. The ability for shareholder to commence shareholder litigation is therefore essential to reduce these agency problems.

### 8.5 Impact on the Market for Corporate Control

The high levels of litigation in the US may affect the ease in which takeovers can occur, and in turn have an effect upon the number of takeovers that are attempted. This may impact upon the MCC. Whether there should be an open MCC will be discussed in the sections below, however ultimately the MCC is an important tool for corporate governance. Takeover litigation regulation should therefore be designed to support and foster, not undermine takeover activity.

#### 8.5.1 Does the Presence of Litigation Suppress the Market for Corporate Control?

It cannot be reliably concluded as to whether the different levels of litigation *actually* have any impact on the number of completed takeovers. To find a causal link would require a further and more complex empirical study to be completed. There are also other factors which will have an effect on the number of completed takeovers in the US. For example, anti-takeover legislation in the US and the relatively unfettered powers target directors have to ward off unwanted takeovers will have a substantial impact on takeover activity. A further difficulty arises due to the type of takeover litigation that is commenced; target shareholder litigation is not commenced to prevent the takeover from succeeding, but instead used as a tactic to increase premiums or change the deal terms.[965] Nonetheless, Krishnan, et al. found that the presence of takeover litigation does have the 'effect of decreasing deal completion probability by 5.8%.'[966] This figure may not seem significant considering around 90 percent of takeovers[967] in the US experience litigation. So whilst the US's propensity to litigate does not significantly impact upon the MCC there is still some effect. This impact is also not entirely modest when compared with the UK, where the almost non-existent level of litigation would have an extremely minimal effect on the MCC.

[965] See Cain and Davidoff Solomon (n517)
[966] Krishnan et al (n514)
[967] Over 100 million value; see Caine and Davidoff Solomon (n537); though this rate has dropped slightly to 87.7 percent according to preliminary figures from Caine and Davidoff's most recent study in 2015.



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It is not, however, just the absence of litigation in the UK that contributes to the operation of the MCC. UK takeover and company law regulation enables a MCC, for example, the structure of the Panel and the content of the Code creates an environment where litigation is not needed. So it may therefore be concluded that the propensity to litigate in the US does have an impact on the MCC but that this impact is not significant. Nevertheless, in comparison to the UK, the US's propensity to litigate does have a greater suppressive effect on the MCC. Whether the suppression of takeover activity matters will depend upon attitudes towards the MCC and whether it should be embraced or rejected. .

Having discussed the benefits of the MCC in chapter two, it can be concluded that any hindrance to its effectiveness would be undesirable. A well-functioning MCC creates 'economic efficiency by allowing outside parties to takeover poorly performing companies.'[968] This is said to occur because of the change in control to a more effective management team, who can then improve the value of the company's existing resources and create allocational efficiency through the reallocation of resources to their most productive and efficient use.

Ineffective managers may therefore be able to entrench themselves within a company using litigation as a frustrating technique. Yet, the propensity to litigate in the US originates not from target directors but from the target shareholders. This litigation is consequently not the type of litigation that would frustrate a bid enabling target directors to continue their employment at the target company. Nonetheless, there is an impact on the MCC (if only marginal) that was established above, which will mean that managers in companies targeted for takeovers will remain, whether the litigation is meant to frustrate the bid or not. This therefore effects the functioning of the MCC and impacts upon the effectiveness of takeovers to act as a tool for creating greater economic efficiency.[969]

[968] Burkart (n15) 4
[969] See Jarrell et al (n32); Loughran, Vijh, (n29); Franks et al (n113); Betton, Eckbo (n27); Schwert (n27); Stulz et al (n27); Ruback, Jensen (n27)



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The propensity to use litigation in the US affects the ability of the MCC to function properly and therefore the merits which emerge from the MCC cannot be fully realised. The UK has a market in which takeovers can occur easily, and it appears that it is an aim of takeover regulation to allow for this.[970] If US regulators wanted to ensure that the MCC could operate fully they could do more to prevent litigation which has the effect of frustrating bids.

**8.6 Conclusion**

The propensity to litigate has a number of impacts on the takeover process that can affect the speed, cost, shareholder welfare and the MCC. On average, takeovers in the US take approximately 89 days longer to complete than those in the UK. The delays caused by litigation can impact upon a target company's ability to focus on the day to day management of the company, a target shareholders' capacity to properly assess the deal, and the bidders' prospects of successfully completing the takeover. Delays in takeovers can also have much more wide reaching effects on market stability and certainty. A drawn out takeover can create false markets in which investors can no longer properly assess the value of a company's shares.

The propensity to litigate in the US also impacts upon the cost of takeovers. The cost of litigation significantly increases the cost of a takeover due to the level of fees that are frequently awarded to target shareholder attorneys. Although UK companies must still pay fees to the Panel, and to their own lawyers, these costs are significantly less than those paid by US companies in lawyers' fees. The distribution of these costs is also impacted by litigation. In the UK costs are distributed evenly, as all companies (even those who are not parties to a complaint) must pay towards the funding of the Panel. In the US target companies are burdened with the costs of litigation. What burden these costs create will depend on the merits of the target shareholders' claim.

[970] i.e. the prohibition for directors to use frustrating action, the ease and speed in completing a takeover bid due to the comprehensive regulation in the Code



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There is also evidence to suggest that litigation in the US suppresses some takeover activity due to the frustrating effects litigation can have. By contrast, takeover activity goes unhindered by takeover litigation in the UK. As such there is an open MCC. This openness however derives from a number of different causes, not just the UK's lack of takeover litigation. If the MCC is considered as an important corporate governance tool then the suppressive effect litigation has in the US may be problematic. What impact takeover litigation has on the MCC is however heavily outweighed by other factors that suppress takeover activity in the US, such as anti-takeover legislation and directors' powers to defend against a bid. If US regulators wanted to encourage a more open MCC then they should first seek to remove those barriers.

Takeover litigation is however, beneficial for US target shareholders. It plays an important function in assuring the transparency of the target board during a takeover. This contributes to an informed shareholder and information asymmetry. Whilst there is certainly scope to reduce meritless claims in the US; and in turn prevent litigation that results in immaterial disclosures, to completely remove shareholders access to litigation would have an impact on their ability to enforce their rights. Consequently, due to the characteristics of the US takeover system, takeover litigation plays an important role in US corporate governance. This is not a role that needs to be played by litigation in the UK as there is a culture of compliance which is created by the Panel and the Code. When a dispute does arise it is more efficient for parties to a takeover to consult the Panel than commence costly and time delaying litigation.



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# Chapter Nine

# Conclusion

## 9.1 Conclusion

This thesis has described and mapped the landscapes of takeover regulation and litigation in the UK and US, explained why there are such diverging levels of litigation in these jurisdictions and evaluated the impact of the presence or absence of takeover litigation on time, cost and the impact on target shareholders.

The second chapter, following the introductory chapter, described the merits of the MCC. The existing literature indicates that MCC provides for a broader, more effective and more efficient form of monitoring than any other corporate governance mechanism can currently offer. This is because hostile takeovers create economic efficiency which generates an overall efficient economy, in which management is submitted to continual checks by the market. Minority shareholders are also protected by the MCC as it allows them to easily exit companies when they are underperforming. These benefits are aided by a practically efficient market, in which relevant available information is rationally assessed by the market providing accurate share price signals. The accuracy of the share price consequently helps to identify both rightful bidders and targets. Whilst there are some valid issues regarding overshoots in the market, the literature indicates that the market is efficient enough to allow the MCC to function on a day to day basis. The only real concern, and an on-going issue for academia in this area, is to understand why these overshoots occur, whether they happen rationally or due to fads and euphoria. This question cannot be fully answered by this research, but whatever the answer, it is still clear that the MCC is a necessary tool for corporate governance in the Anglo-American market system.

The third and fourth chapters described the UK takeover regime and identified the level of takeover litigation in this jurisdiction. The third chapter described the process and regulation of takeovers in the UK, where there are two processes in which a takeover can be completed, specifically via a takeover offer or a scheme of arrangement. Both are regulated by the Code,



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and by certain provisions of company law. The Panel plays a key role in the regulation of takeovers in the UK by ensuring that the Code is adhered to, giving guidance, and dealing with any breaches of the Code and regularly updating and changing its rules. The behaviour of the target director, which includes whether any defensive mechanisms are used to defeat takeovers, is regulated by the Code, but for the main part is enforced by directors' duties within the Companies Act 2006. Directors will therefore find it extremely difficult to defend against an unwanted takeover, including commencing litigation. This is because the UK system of regulation is primarily aimed at allowing the target shareholders to decide on the merits of the bid, and whether a company is taken over (either by a takeover offer or scheme of arrangement). Target shareholders, and bidders, are therefore still able to commence litigation under the UK system.

However, the findings of the empirical search undertaken in chapter four, demonstrated that less than one percent of takeover litigation is brought in the UK during the process of a takeover. This level of litigation does not seem to have increased or decreased in the last three decades, and therefore remains at a steady state. The main instigators of this litigation are the target shareholders and the bidder, and claims are usually against the target company. The most popular causes of action in which to pursue takeover litigation are breaches of director's duties, unfair prejudice under s.994 of Companies Act 2006, negligent misstatements and a breach of common law non-directors fiduciary duties. The litigation that is brought is, however, rarely successful, as 71.4 percent of claims fail to give the claimant their desired outcome. There are however alternatives to pursuing complaints parties may have during a takeover by seeking a decision of the Panel. The Panel nevertheless delivers formal rulings in less than two percent of takeovers. This figure is slightly more than the amount of takeover litigation brought but is still not a significant amount. It can therefore be concluded that there is not a propensity to litigate, or to commence formal complaint proceedings with the Panel, during or after a takeover in the UK by the main parties to a takeover.

The fifth and sixth chapters described the takeover regime in the US and the level of litigation that is present in this jurisdiction. There are two main ways in which a takeover can be completed in the US, which are distinct from the UK approaches; these are either via a single-step or two-step merger. The method that will be used will generally depend upon



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whether the bid is hostile or friendly. For example, if the bid is a one which is hostile then the two-step method will be more appropriate. Both of the different methods are regulated by federal and state regulations. Federal laws, for the most part, regulate the process of the takeover, ensuring that a proper process is followed and that parties to the bid meet the disclosure requirements. The SEC both overseas and enforces federal regulation. By contrast, state law plays a greater role in regulating the behaviour of the parties to the bid, namely the behaviour of the target directors. These laws do this by requiring target directors to not only meet the standard fiduciary duties placed on any director making any commercial decision, but also to meet enhanced duties. These enhanced duties allow judges to scrutinise decisions made during a takeover in order to be certain that directors are acting in the best interests of the company, and not for any other self-serving reasons. Directors are also obligated to disclose material information to shareholders during a takeover under the state law fiduciary duty of disclosure. This is in contrast to the UK, where directors are not subject to a specific fiduciary duty of disclosure.

The heightened examination by judges of directors' commercial decisions in the US are however justified by the courts on the grounds that takeovers put directors in an odd situation, in which it is more likely for there to be a conflict of interest between what is best for the company and what is best for the individual director (to avoid directors self-dealing). Generally in the US, as with the UK, directors are permitted a great deal of discretion when making commercial decisions and therefore judges will not decide on the merits of those decisions. The enhanced fiduciary duties placed on target directors during takeovers, however, allow the courts to disregard this norm and decide whether the behaviour of the director was reasonable and necessary in the circumstances. Despite these enhanced duties directors in the US still retain a great deal of discretion when deciding on how to deal with a takeover bid (unlike in the UK). This is evidenced by the recent "just say no" cases, in which target directors have been able to defend against an unwanted takeover bid, despite whether the shareholders wish to sell or not, on the grounds that the takeover would be detrimental to the long-term business plans of the company. This is a divergence from the position in the UK, where directors cannot generally defend against an unwanted bid whether the takeover has merits or not.



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Chapter six, established, using the recent study of Cain and Davidoff Solomon, that 87.7 percent of high value transactions experienced litigation in 2015. This figure is also reflected in the findings of Daines and Koumrian who found that 93 percent of the transactions they recorded involved litigation commenced by the target shareholders. Based on this data it is clear that there is a greater propensity to litigate in the US than in the UK. The degree of difference is however difficult to ascertain due to the differences in the transactions recorded in the UK (with the US studies targeting high valued transaction only compared with all values of transactions which were of interest in the UK study). However, even taking this into account it is clear that US parties to a takeover are still more likely to commence takeover litigation than their UK counterparts.

US takeover litigation is almost always brought as a class action case on behalf of target shareholders who request additional disclosures to be made.[971] In the UK both the target shareholder and the bidder commence an almost equal amount of litigation. UK shareholders generally allege unfair prejudice or a breach of a director's duty, and bidders usually bring claims against other third parties, such as advisors regarding conflicts of interest. As such, there is not only a difference in the levels of litigation brought in the US and UK but also a difference in the motivations for bringing the claims. US litigation seems to solely revolve around information forcing, as very few cases settled for amendments to the takeover agreement or for a monetary benefit.

The seventh chapter explained why the UK and US have such diverging levels of litigation. Four candidates were offered to do this. Firstly the US has imposed greater statutory obligations for disclosure upon their directors and made this available for shareholders to pursue. Secondly, the class action and the encouragement of lawyers mean that shareholders in the US are more likely, and are more easily able to litigate as compared to UK shareholders. Thirdly, the presence of the Panel provides a good alternative to litigation and the comprehensive Code precludes the kind of behaviour US directors are sued for in the US. Fourthly, and finally, the different litigation cultures in each jurisdiction add to the

[971] Cain, Davidoff Solomon (n517) 13



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explanation due to the different behaviours the various parties to a takeover have adopted in both jurisdictions.

Chapter seven therefore established that the US statutory fiduciary disclosure obligations are more extensive than their UK equivalent. More crucially however, the form of action that must be adopted to enforce these provisions is significantly different. In the US, the disclosure obligations of directors are owed not only to the company, but also constitute obligations owed personally to shareholders, in respect of which shareholders can bring a personal action. So, in the US, allegedly inadequate directorial disclosures in takeovers can generate both derivative claims, and personal actions by shareholders. There are very few derivative claims commenced in the US, because even in the US, derivative claims are limited in scope and are difficult to launch. By far, the most popular form of action is the personal action.

These factors, however, still do not give a complete explanation for the abundance of litigation in the US. The fact that such actions can be brought as personal actions is important, but it only provides a starting point for a fuller explanation. It would count for little if there were not an efficient method of bringing such personal claims. In the US, shareholders may use the class action lawsuit without which, there would be few personal claims. The availability of target shareholders to use the class action in the US to commence claims for a breach of a fiduciary duty increases the number of personal actions significantly.

However, even this may not fully explain the prevalence of US target shareholder litigation. Yes, the availability of the class action encourages many more shareholders to bring personal actions; but that number would likely still be more modest than it currently is, were it not for the tendency of lawyers themselves to encourage personal claimants to launch and continue more claims. The personal action gives the kindling; the class action encourages more shareholders to strike the match; and the lawyers pour the petrol on the flames for reasons of self-interest.



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Turning to the UK most of these elements are lacking. First, in the UK, the less extensive disclosure obligations are owed only to the company itself (bar the s.90 FSMA claim). They do not constitute duties owed to and enforceable by shareholders personally. Shareholders cannot bring any personal action in respect of a failure by target directors to make the required disclosures. If disclosure obligations of target directors are breached, the action must be taken by the company itself or, if it will not, by a derivative claim commenced by shareholders, but only for the benefit of the company. The derivative claim procedure in the UK is however beset with many problems and weaknesses which mean that it is infrequently used. Consequently, even where there are inadequate disclosures which breach a directors duty, there are no personal actions (because they cannot be brought), no corporate actions (because the board won't sue) and very few derivative actions (for the reasons given above).

Nonetheless, there are a small number of personal actions brought by target shareholders, alleging that directors have breached disclosure obligations required under s.90 FSMA. These claims are generally brought using collective actions such as GLO's or representative actions, which also have significant failings and as such generate very little litigation. These reasons create the primary bars to shareholder actions in the UK, and therefore explain the lack of shareholder litigation. However, even if US style class actions were adopted in the UK, litigation would still rarely be commenced due to the presence of the Panel and the Code. Shareholders in the UK therefore have very little to encourage them to strike the match.

Chapter eight evaluated the impact of the different propensities to litigate, and identified a number of its effects on the takeover process. These relate to time, cost, benefits to shareholders and the impact on the MCC. On average, takeovers in the US take approximately 89 days longer to complete than those in the UK. The delays caused by litigation can impact upon a target company's ability to focus on the day to day management of the company, a target shareholders' capacity to properly assess the deal, and the bidders' prospects of successfully completing the takeover. Delays in takeovers can also have much more wide reaching effects on market stability and certainty. A drawn out takeover can create false markets in which investors can no longer properly assess the value of a company's shares.



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The propensity to litigate in the US also impacts upon the cost of takeovers. The cost of litigation significantly increases the cost of a takeover due to the level of fees that are frequently awarded to target shareholder attorneys. Although UK companies must still pay fees to the Panel, and to their own lawyers, these costs are significantly less than those paid by US companies in lawyers' fees. The distribution of these costs is also impacted by litigation. In the UK costs are distributed evenly, as all companies (even those who are not parties to a complaint) must pay towards the funding of the Panel. In the US, target companies are burdened with the costs of litigation.

There is also evidence to suggest that litigation in the US suppresses some takeover activity due to the frustrating effects litigation can have. By contrast, takeover activity goes unhindered by takeover litigation in the UK. As such there is an open MCC. This openness however derives from a number of different causes, not just the UK's lack of takeover litigation. If the MCC is considered as an important corporate governance tool then the suppressive effect litigation has in the US may be problematic. What impact takeover litigation has on the MCC in the US is however heavily outweighed by other factors that suppress takeover activity, such as anti-takeover legislation and directors powers to defend against a bid. If US regulators wanted to encourage a more open MCC then they should first seek to remove those barriers.

Takeover litigation is, however, beneficial for US target shareholders. It plays an important function in assuring the transparency of the target board during a takeover. This contributes to an informed shareholder and information asymmetry. Whilst there is certainly scope to reduce meritless claims in the US, and in turn prevent litigation that results in immaterial disclosures, to completely remove a shareholders' access to litigation would have an impact on their ability to enforce their rights. Consequently, due to the characteristics of the US takeover system, takeover litigation plays an important role in US corporate governance. This is not a role that needs to be played by litigation in the UK as there is a culture of compliance which is created by the Panel and the Code. When a dispute does arise it is more efficient for parties to a takeover to consult the Panel than commence costly and time delaying litigation.



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This work has provided an original contribution to the understanding of the levels of takeover litigation in the UK, and in explaining the different propensities to litigate during takeovers in the UK and US. It has also provided an original contribution to the achievement of the correct regulation of takeovers in the UK. This is a contemporary legal issue that is frequently debated, both by academics and governmental agencies; and laws which function in and affect society today. The findings of this research will substantially add to the knowledge and understanding of the regulation of takeovers by critically examining the diverging levels of litigation, and the effect of both the absence and presence of litigation. This will enable a unique and clear insight into how the propensity for litigation should be managed through the regulatory and institutional framework in the UK, and what economic and social benefits will follow those frameworks if they are correctly managed; an objective which this project aims to clarify and thereby adding an original contribution to this field of study. By addressing different issues and continually adding to this topic we can ensure a viable takeover system. A sustainable and working system of takeover regulation will greatly assist in the growth and governance of companies in the UK.

Finally, the thesis presented here suggests a number of avenues for future research. Perhaps the most ambitious of these, and the one I shall mention here, concerns the future development of both the UK and the US regulatory regimes for takeovers. Although this work has sought to evaluate the consequences of the different propensities to litigate in the UK and the US, it has not described in any detail how either country might respond to the different litigation landscapes the thesis has portrayed. Future research might, then, focus on developing policy responses, for both subject jurisdictions, to the evaluatory arguments presented here.



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## APPENDIX ONE

## INTERVIEW CONDUCTED WITH M&A LAWYERS

Whilst the case study conducted for this paper gave data as to the 'population' of UK takeover-related cases leading to recorded judgments (and Panel rulings), what was lacking was the practitioner's insight and commercial awareness of the strategic role which litigation does, or does not, play within the takeover process. What also was crucial was establishing whether underneath the recorded court cases of takeover litigation (which were the subject of this case study) there weren't cases that had begun but had settled before they reached the court. If this was the case then the UK may have had a greater propensity to litigate than what could be identified by collecting court recorded takeover cases.

Four top lawyers, one of whom had been a member of the Panel, from leading M&A firms in the UK agreed to speak with me. I also spoke with the Deputy Director of the Panel. The subject headings for discussion included the practitioners' general perceptions of the UK takeover environment; general experience of the level of takeover litigation in UK; and complaints and the causes of action used to pursue takeover litigation. The below summarises what was discussed in the interview in response to the discussion points.

When asked about the level of takeover litigation in the UK, the interviewees agreed that the levels were indeed very low. The interviewees however differed as to whether they would ever use litigation during a takeover bid. One noted that litigation was not even threatened by their firm because "everyone knows it an empty threat." The other however suggested that whilst there is "almost no litigation, there were somethings that could be done." For example, you can litigate over the breach of confidentiality or conflict of interest, which he stated were the main reasons for brining takeover litigation. He cited the cases of M&S, Minorca and Hoylake which can possibly be used to bring regulatory litigation, but noted there is a fine line because of the quasi-judicial process regarding takeover regulations.[972]

When asked about how their client's takeover complaints were dealt with by their firm the interviewees both said that they would approach the Panel. They would bring any complaints

[972] This refers to the court's reluctance to get involved in the takeover process because it is the domain of the Panel



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to the attention of the Panel, or if there was an issue with a breach of confidentiality or conflict of interest they would ask the Panel to have the party involved removed from the deal. One interviewee who acts principally on behalf of bidders stated that the most complained about issue is that the target board is frustrating the bid, or if there is any possibility that the target board is frustrating the bid. He noted that target boards can usually frustrate bids by changing the nature of the company and diluting interests of shares. After approaching the Panel about this specific complaint, the Panel would require the target board to get a shareholder vote on their actions if the shareholders agreed then they can carry on with their frustrating action and there would be nothing the bidder could further do to prevent this.

When asked about the Panel's involvement with resolving complaints the interviewees noted that they do not always have to consult the Panel but there are definitely things which need clarifying and can often trigger consultation. For example on noted that they "will usually only have to consult the Panel regarding the general principles as these are more vague." But, "the Panel makes decisions on bids every day, literally on a daily basis." The interviewees also explained, from their perspective how the Panel resolves the complaints. One interviewee said there is an internal process in the Panel, where you can get a formal ruling and hearing, and can also appeal. When making decisions the Executive is very careful before it gives a ruling. This is because the Panel "lives and dies by its decisions" and it knows it. The Code however avoids any problems in the first place. So there should be little for parties to complain about. Complaints are however made but there is a process to be followed. There are frivolous complaints, but they usually don't have grounds to proceed. They are however still listened to by the Panel. Complaints during the takeover process are resolved by the Panel through dialogue. There are always some people who are unhappy, but if their complaint is real then it is dealt with by the Executive.

If brining litigation, one interviewee noted that generally the cause of action would be via a contractual or fiduciary duty. It will be a contractual cause of action because of an engagement between advisors and the client, or tortious where there has been a breach of a fiduciary duty such as a conflict of interest. The cause of action will generally always be grounded in common law. One interviewee noted that it wasn't tremendously difficult to bring these types of claims, but that it would be easier if they had the ability to bring class actions. There is, however, he explained a disincentive of costs which is a major factor in the



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UK, this must be considered if they were to lose. Therefore he concluded that there is definitely more risk in the UK to bringing these types of claims.

When asked what role they play as a lawyer in the takeover process the interviewees noted that their role requires a lot of expertise in takeovers and a detailed knowledge of the Code. ‘Tactics are interlinked with the rules of the code – the rules are very complicated. Lawyers need to know the Code backwards, which used to be the job of the bankers now it is the lawyers’ job because the rules became too complicated. I will advise clients through these rules and advise on how to achieve their tactical goals without breaching the code.’



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## APPENDIX TWO

## CASE LIST

*Eclairs Group Ltd and another v JKX Oil and Gas plc and others*[973]

A special resolution to prevent a takeover bid was passed by the defendant in order to weaken the power of the claimants who were suspected of 'raiding' the company in order to devalue it with an ultimate aim of acquiring the company at less than its proper value. The resolution had the effect of serving restriction notices on the claimants which prevented them from voting or transferring shares. The claimants sought interim relief to challenge the validity of the restrictions. On the evidence it was held that the directors did have reason to believe that they had not been given proper information by the claimants, and accordingly their power of restriction had been capable of exercise. However the power to impose restrictions had been exercised for a purpose which had not been a proper one for the purposes of that power. Therefore, its exercise would be set aside. The claim was commenced prior to a formal bid being made.

*Re Ricardo Group plc (No 3)*[974]

Ricardo Group plc was the subject of a takeover bid. A reply by shareholders of the Ricardo Group to a notice under the Companies Act 1985 s.212 did not name the true owners of certain target shares. The shares were therefore made subject to restrictions. An application was made to have the restriction lifted. It was held that although a company had a prima facie right to know who owned its shares, it was a matter for the discretion of the court whether a freezing order should be imposed or continued. Restrictions were often sought by directors not to determine a matter which actually affected the company but to defend their own position. On the facts, a failure to lift the restriction might prevent the takeover bid going ahead and this could prejudice those shareholders who wanted to accept it. The restriction would was discharged.

[973] [2013] All ER (D) 17 (Sep)
[974] [1989] BCLC 771



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*Re T R Technology Investment Trust plc*[975]

A company began an investigation into acquisitions and disposals of its shares in order to ascertain the beneficial ownership. The company was dissatisfied with the replies it had obtained to its s.212 notices. The responses failed to provide a plausible commercial explanation of what was happening and therefore the company sought and obtained an order under s.216, on an ex parte application, against a number of the respondents, freezing the shares. Since the information supplied in response to the s 212 notices did not enable the company to identify the real owner of the shares, the judge was entitled to make the order freezing the shares. It was no objection to the granting of an order freezing its shares that the board of the company was seeking the information to ward off a take-over bid. However, the consequences of continuing the restriction had to be taken into account and since the shareholders were willing to give a satisfactory undertaking not to dispose of the shares pending trial, the order made with respect to the shares would be discharged.

*Re Geers Gross plc*[976]

A company began an investigation into acquisitions and disposals of its shares in order to ascertain the beneficial ownership. The company applied for and obtained an order under the Companies Act 1985 s 216, imposing restrictions of share transfer. An application was made to the court to have the restrictions removed, contending that the restrictions could be lifted, even though the relevant information had not been disclosed, where an undertaking was given that the shares would be sold in the open market. The application was dismissed.

*In re Ashbourne Investments Ltd*[977]

An investigation by the board of trade was conducted which discovered that shares had been bought by a Swiss bank as an agent. The bank refused to disclose the names of their customers who owned the shares. A restriction was then placed on the transfer of the shares. Meanwhile another company made a successful takeover for the company that was subject to the investigation. The bidder became bound to purchase the restricted shares, however as

[975] [1988] BCLC 256
[976] [1988] 1 All ER 224
[977] [1978] 1 WLR 1346



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long as the restrictions remained in force the shares could not be transferred. This had the effect that the bid became frustrated. The bidder and the target therefore applied to the court to have the restrictions lifted. A partial release of shares from the restrictions was permitted.

*Re Expro International Group plc*[978]

A scheme of arrangement was due to be sanctioned by the court when the target shareholders made an application for an adjournment of the sanction for 14 days; the purpose of which was to give a potential rival bidder the opportunity to make a further bid for the company. The shareholders submitted that the target board appeared not to have taken into account that the acceptance of the rival bidder's proposal which would have triggered an orderly auction process overseen by the Panel under the provisions of the Code that could have resulted in an increased price to the benefit of the shareholders. The application was dismissed by the court.

*In re Grierson, Oldham & Adams Ltd*[979]

Minority shareholder opposed a scheme of arrangement due to a belief that the company had been undervalued and therefore refused to sell their shares. An application was made for the compulsory acquisition of the shares of a dissenting minority. The court granted the order.

*In re Bugle Press*[980]

An application by the minority shareholder was made to oppose the compulsory sale of his shares on the grounds that the shares had been undervalued. The court granted the order the shareholder sought.

[978] [2010] 2 BCLC 514
[979] [1967] 1 All ER 192
[980] [1960] 3 WLR 956



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*Heron International Ltd and others v Lord Grade, Associated Communications Corp plc and others*[981]

The target directors owned a majority of the shares in the target company. There was a contested takeover bid for the target, but the directors had an interest in one particular bidder as they had agreed to sell their majority holding to them. The claimants, who sued as representatives of the shareholders in the defendant company, sought an interlocutory injunction to prevent the transfer of the directors' shares to their preferred bidder. It was held that the transfer of the shares was void.

*Re Astec (BSR) plc*[982]

A bidder obtained 45% of the issued shares in a target company. The bidder later increased its shareholding to 51%. Having failed to obtain support for its offer to purchase the remaining shares in the company from the majority of the board of directors, the bidder issued a press release to recommend its offer to the shareholders. Soon after, the bidder requisitioned an extraordinary general meeting of the company pursuant to s 368 of the Companies Act 1985 to remove three directors from the board and replace them with its own nominees. The resolutions removing the directors were passed, leaving the directors nominated by the bidder in a majority of six to four. However, a petition was presented under s 459 which alleged unfairly prejudicial conduct of the company's affairs. The petitioners, by way of relief, sought an order that the bidder be ordered to purchase the remaining shares of the company at a fair value. The bidder then terminated discussions as to its proposed bid for the remaining shares in the company and issued a notice of motion seeking to strike out the petition. The court found on the evidence that the substance of the s 459 claim was without purpose. Since the petition was being used for the purpose of exerting pressure on the bidder in order to achieve the making of a takeover bid, it was an abuse of process and would be struck out.

[981] [1983] BCLC 244
[982] [1998] 2 BCLC 556



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*R v Monopolies and Mergers Commission and another, ex parte Argyll Group plc*[983]

In the course of a contested takeover bid, one of the rival bidders was referred to the Monopolies and Mergers Commission. The effect of the referral was to cause the rival bidders offer to lapse and prevent it from making any new offers while the commission investigated the bid. Since the reference would therefore be a severe handicap to the rival bidder in its attempt to out-bid the other bidder, it communicated that it intended to make a new offer on different terms from the previous offer, which it hoped would be acceptable. It also requested that the chairman of the commission exercise their power to 'lay … aside' and not proceed with the reference if it appeared that 'the proposal to make arrangements such as are mentioned in the reference [had] been abandoned.' The chairman agreed to not proceed and the other bidder then sought a judicial review of this decision. The appeal was dismissed.

*Howard Smith Ltd v Ampol Petroleum Ltd and others*[984]

In a contested bid the target directors issued shares in order to dilute the influence of the majority shareholders which would allow a successful takeover to be completed by the bidder. The shareholders alleged that the directors had issued the shares for an improper purpose and were therefore acting outside of their powers. It was held that the directors had indeed exercised their powers for an improper purpose, and that the issue of the shares should be set aside.

*Criterion Properties plc v Stratford UK Properties LLC and others*[985]

Joint venture partners entered into a supplementary agreement containing a poison pill buy-out clause in order to protect the claimant company from a takeover. The agreement entitled the defendant company to buy out its interest on favourable terms in the event of another party gaining control of the claimant company or on removal of its chairman or managing director. The arrangement achieved its purpose of deterring takeover negotiations with a potential bidder. The claimant alleged that the agreement was void because it was entered

[983] [1986] 2 All ER 257

[984] [1974] 1 All ER 1126

[985] [2003] 2 BCLC 129



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into improperly by the board of directors and that the defendant had actual notice of this breach of duty. The claimant applied to have the agreement set aside. It was held that the agreement entered into by the directors was outside of their powers and that the agreement would be set aside.

*Bamford and Another v Bamford and Others*[986]

An allotment of ordinary shares was issued by the directors, who were empowered by the articles, in order to counter a takeover bid. The directors' actions were then ratified by the company in a general meeting. Some shareholders however alleged that the directors' actions were not in best interests of company and were in excess of their powers. It was held that the allotment could be ratified by the company in general meeting and therefore the issued shares would not be set aside.

*Hogg v Cramphorn Ltd and Others*[987]

An offer was made to the chairman and managing director of the target company for the bidder to buy the whole of the issued preference shares. The proposed takeover however would lead to a change in the nature of the companies trading which the directors considered would not be in the best interests of the company. The directors therefore issued and allotted preference shares to trustees for the benefit of the employees. The claimant, who was a target shareholder suing on behalf of the target company, alleged that the issue of shares was an improper exercise of the directors' powers and applied to have the allotment set aside. It was held that the allotment was invalid unless it could be ratified by the shareholders.

*Gething v Kilner*[988]

A bidder made an offer for a target company, and a joint announcement was made. The target company hired a firm of stockbrokers to advise on the merits of the offer. Initially it was decided that the offer was fair and reasonable, later however they were advised by the

[986] [1969] 1 All ER 969
[987] [1966] 3 All ER 420
[988] [1972] 1 All ER 1166



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stockbrokers that the offer was inadequate and that the target board should not recommend the takeover. The claimants, who were shareholders of the target company, dissented from the offer, and sought interlocutory injunctions to restrain the target board from taking further steps to recommend the offer and the bidder from declaring or purporting to declare that the offer was unconditional. It was held that the interlocutory injunctions should not be granted.

*Marks and Spencer plc v Freshfields Bruckhaus Deringer*[989]

The claimant, a target of a takeover, applied for an injunction to a takeover bid on the grounds that the defendants, who were the solicitors advising the bidder, were also the solicitors of the target company. The claimant alleged that there would be a significant conflict of interest and that the defendants would have access to confidential information which would be beneficial to the bidder in succeeding in the takeover bid. The application for the injunction was granted.

*Young and others v Robson Rhodes (a firm) and another*[990]

The claimant made an application for an injunction to restrain a merger in order to protect confidential information. The claimant had alleged that the defendant accountants acting, who acted on behalf of the claimants, were putting themselves in a conflict of interest in deciding to merge with another firm. The claim was dismissed and the merger could proceed.

*Interbrew SA v Financial Times and others*[991]

The claimant was considering a takeover of another company. It therefore requested a presentation from its financial advisors containing confidential information, which also disclosed the fact that the claimant was considering making a takeover bid. Such information was market sensitive, being calculated to affect the market price of the shares of both companies. Shortly thereafter, a person whose identity was unknown obtained a copy of the presentation and prepared 'doctored' copies. The copies of the presentation were sent to the

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[989] [2004] All ER (D) 114 (Jun)
[990] [1999] 3 All ER 524
[991] [2001] All ER (D) 313 (Dec)



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five defendants, who published certain documents of the doctored copies. The claimant alleged that there was a breach of an equitable obligation of confidence owed by the defendants to the claimant. The claim was successful and the defendants were ordered to deliver up the documents along with the name of the source.

*Dunford and Elliott Ltd v Johnson and Firth Brown Ltd*[992]

The claimant company decided to make a rights issue to their shareholders. The majority shareholders however invited the defendant to underwrite a significant amount. The Defendant was given confidential information regarding the financial prospects of the claimant, but decided against the offer. They later made a press announcement that they were making an offer to the claimant's shareholders. The claimant therefore applied for an injunction to forbid the use of the confidential information in order to restrain the takeover bid. The claim was dismissed.

*Re Coroin Ltd (No 2); McKillen v Misland (Cyprus) Investments Ltd and others*[993]

Claimant alleged that a share transfer was contrary to the pre-emption rights as outlined in the shareholder agreement. The appropriate offer had not been made to the claimant when it should have been, with the consequence that 35.4% of shares came under the control of another. The relief sought was an order entitling the claimant to purchase the shareholding or exercise of his pre-emption rights. The court held that there had been no breach of the pre-emption rights. Claim brought after there had been a change in control.

*Re Sedgefield Steeplechase Co (1927) Ltd, Scotto v Petch and others*[994]

An offer was made to buy all the shares of a company. The majority shareholder agreed to sell their shares, but the shareholder who owned the remaining shares refused to do so. The majority shareholder entered into agreements with the bidder, agreements which they believed did not trigger the pre-emption rights. The minority shareholder however claimed

[992] [1977] 1 Lloyd's Rep 505
[993] [2012] All ER (D) 41 (Mar)
[994] [2000] 2 BCLC 211



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that they did. It was argued that the company's articles of association conferred on its members' rights of pre-emption over the shares of fellow members which were not transferred to other members of the company, their families or other persons as agreed. The rights were triggered when a member 'intends to transfer shares', in which event they are required to give notice in writing of their intention to the board. It was held that the transfer of shares in this instance was not in contravention of the company's particular pre-emption provisions.

*Kleanthous v Paphitis and others*[995]

A director personally bought a company following a decision by other directors not to acquire that same company. Minority shareholders commenced a derivative claim alleging breach of fiduciary duties in acquisition of the company. Permission was not granted to continue the derivative claim. The claim was brought after the director's takeover of the company was completed.

*Arbuthnott v Bonnyman and others*[996]

The claimant held an 8.9% of shares in the defendant company. The bidder, which was a vehicle for the other shareholders in the defendant company, made an offer to acquire all shares in the same company. The acquisition was approved, with only the claimant voting against the resolution. The transfer of all shares (other than those held by Arbuthnott) took place under the terms of the bidder's offer. The validity of a transfer of shares was challenged by the claimant who brought proceedings contending unfair prejudice. The claim was dismissed. The claim was brought after there was a change in control.

[995] [2011] EWHC 2287 (Ch)
[996] [2015] All ER (D) 218 (May)



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*Franbar Holdings Ltd v Patel and others*[997]

The defendant company was wholly owned by the claimant company between 2001 and 2005. Thereafter, the claimant sold 75% of the shares in the defendant company to a third party company. At the same time, the claimant and the third party company entered into a shareholder's agreement. The claimant made a number of complaints relating to the manner in which the business of the defendant company had been conducted. The claim was unsuccessful.

*Rock Nominees Ltd v RCO (Holdings) plc (in liquidation) and others*[998]

A petition was made by the minority shareholders alleging that the sale of the company had been made at an undervalue and therefore the target directors had breached their fiduciary duties. The claim was dismissed.

*Re BSB Holdings Ltd (No 2)*[999]

During the process of a merger, minority shareholders alleged that they had been oppressed due to funding arrangements which divided groups of shareholders in to classes with different interests. The result of the different groupings meant that their interests became diluted and their influence diminished. It was claimed that the directors should treat all groups fairly and that it was a breach of their duties not to do so. The claim was dismissed on the evidence provided.

*IFE Fund SA v Goldman Sachs International*[1000]

The defendant was a bank facilitating financing to a French company to takeover a British company. The claimant provided the finances. After the takeover was complete however the company failed after deceit of the auditors involved in the takeover had been revealed. It was alleged by the claimant that the bank had been in breach of its duty because of

[997] [2008] All ER (D) 14 (Jul)
[998] [2004] 1 BCLC 439
[999] [1996] 1 BCLC 155
[1000] [2007] EWCA Civ 811



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misrepresentations made concerning the target company to the claimant. The claim was dismissed.

*Caparo Industries plc v Dickman and Others*[1001]

Following their takeover of a company, the claimant brought an action against the target company's auditors, alleging that the company's accounts were inaccurate and misleading. The claimant's contended that the auditors had been negligent in auditing the accounts, and that the takeover bid had been made on the basis of the audited accounts. Therefore the auditors owed them a duty of care either as potential bidders or as existing shareholders. It was held that the auditors owed the respondents a duty of care as shareholders although not as potential investors.

*James McNaughton Papers Group Ltd v Hicks Anderson & Co (a firm)*[1002]

The claimant entered into negotiations with a rival company for an agreed takeover at a time when they were in financial trouble. The chairman of the target asked the defendants, who were their accountants, to prepare draft accounts as quickly as possible for use in the negotiations. The accounts when prepared were shown to the claimants. After the takeover was completed the claimant discovered certain discrepancies in the accounts. They brought an action against the defendants alleging that the draft accounts had been negligently prepared and that in going through with the takeover they had relied on the draft accounts and the statements. On the evidence the defendants owed no duty of care to the claimant in respect of the accounts.

*JEB Fasteners Ltd v Marks, Bloom & Co (a firm)*[1003]

The claimant entered into negotiations to takeover a company. During the negotiations the defendants, who were the target company's accountants and who knew that the claimant was negotiating to takeover the company, produced audited accounts for the company's first

[1001] [1990] 1 All ER 568
[1002] [1991] 1 All ER 134
[1003] [1983] 1 All ER 583



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trading year. Having certified them as being accurate the defendants made the accounts available to the claimant. In light of the information the claimants decided to takeover the target company, however the claimants suffered considerable loss as a result. The claimants therefore brought an action against the defendants claiming damages for breach of duty of care as prospective buyers of the company. The claim was dismissed.

*Sharp and others v Blank and others*[1004]

The claimant shareholders of Lloyds brought claims against its directors, alleging breach of fiduciary and tortious duties in respect of Lloyd's acquisition of another HBOS. The shareholders alleged that the directors of Lloyds had the benefit of detailed disclosure by HBOS and vastly superior knowledge to that of the shareholders and that, in giving advice, making recommendations and providing information, the defendants had voluntarily undertaken responsibility for the correctness of advice and recommendations given. The court found that although a director of a company could owe fiduciary duties to the company's shareholders, he did not do so by the mere fact of being a director, but only where there was, on the facts of the particular case, a 'special relationship' between the director and the shareholders. That special relationship had to be something over and above the usual relationship that any director of a company had with its shareholders. It was not enough that the director had more knowledge of the company's affairs than the shareholders. The duty of sufficient information that was allegedly breached by the target directors was held not to be likened to a fiduciary duty.

*MAN Nutzfahrzeuge AG and others v Freightliner Ltd and others*[1005]

The claimant alleged that there had been fraudulent misrepresentations made by the defendant's accounts officer. The claimant had acquired another company from the defendant by way of a share purchase agreement. It subsequently transpired that the accounts of the company had been persistently manipulated. The claimants issued proceedings seeking to recover damages for the false accounting because it had not given a true and fair value of the target company's financial position, and that there had accordingly been breaches of

[1004] [2015] EWHC 3220 (Ch)
[1005] [2007] All ER (D) 65 (Sep)



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representations and warranties in the share purchase agreement. The court found that the defendant was liable to the claimant in deceit and for breaches of the share purchase agreement.

*Ferguson and others v Spicer & Pegler (a firm) and another*[1006]

The claimant's primary case claimed that during the relevant period the defendant, acting for a company they wished to takeover, negligently made material misstatements to the claimant which he relied upon when taking over the company. The claimant argued that had it not been for the misstatements he would not have done so. The claimant was successful in his application and was awarded damages.

*Yorkshire Enterprise Limited and another v Robson Rhodes*[1007]

The claimant alleged that an investment to takeover a company was made in reliance on misstatements negligently made by the defendants in the target companies audited accounts. The court held that on the facts there had been a breach of duty due to the negligent misstatement and damages were awarded.

*Amalgamated Industrials Ltd and others v Johnson & Firth Brown Ltd*[1008]

An agent of the claimant placed himself in a situation where his own interest conflicted with his duty to his principal as the result of an arrangement with the bidder (to what could amount to as a bribe), the person with whom he was, on behalf of the claimant, negotiating with the regarding a takeover of the claimant. It was alleged that there was a conflict of interest and that confidential information would not be protected.

[1006] [1994]
[1007] [1998]
[1008] 1980 A No 3937



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*Lonrho plc v Fayed and others (No 4)*[1009]

The claimant company alleged that the defendants had deprived it of the opportunity to acquire the shareholding of a certain public company by misrepresenting to the public authorities their financial background and, in particular, the sources available for their own acquisition of the shareholding. After initial discovery failed to disclose sufficient information the claimant obtained an order for production of those defendants' financial documents, including documents prepared for taxation purposes and held by them and their advisers. The defendants claimed that the documents attracted public interest immunity and declined to produce them. The defendants therefore appealed against the order. The appeal was dismissed.

*Dawson International plc v Coats Paton plc and Others*[1010]

A contract was agreed between the bidder and the target that stated that the target board would recommend the bidder's takeover offer and not co-operate with any rival bidders. Later a rival bidder made an offer for the target company which was accepted. The initial bidder raised an action against the target company alleging that the agreement had been breached and sought reimbursement for the expenses they had incurred in taking steps to implement the takeover, which had been wasted when their bid lapsed because of the rival bid. It was held that the agreement could not be invalidated, but that the claim for reimbursement would be dismissed.

*Morgan Crucible Co plc v Hill Samuel Bank Ltd and others*[1011]

The claimant announced a takeover bid of a target company. After the bid became unconditional it was alleged that the target negligently prepared financial statements and a profit forecast which the bidder relied on. The bidder made a claim that there was a duty of care owed to a bidder or potential bidder. The question at hand was whether there was sufficient proximity between the bidder, the target board and the advisers of target company to found an action in negligence. It was held on the assumed facts the target intended the

[1009] [1994] 1 All ER 870
[1010] [1989] BCLC 233
[1011] [1991] 1 All ER 148



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bidder to rely on the pre-bid financial statements and profit forecast for the purpose of deciding whether to make an increased bid, and the bidder did so rely on those statements and the profit forecast, it was plainly arguable that there was a relationship of proximity between each of the target and the bidder in this instance sufficient to give rise to a duty of care.

*British and Commonwealth Holdings plc v Quadrex Holdings Inc*[1012]

The claimant made a bid for another company with the intention of selling off the wholesale broking division it had, which consisted of two moneybroking companies, if the bid was successful. The defendant, also engaged in the moneybroking field, and made a rival bid for the target with the aim of acquiring its wholesale broking division. By an agreement the claimant and the defendant agreed that the defendant would withdraw its bid for the target and the claimant, if its bid was successful, would sell the target's wholesale broking division to the defendant. The claimant's bid was successful, and the agreement between the claimant and the defendant became operative. The defendant however could not complete the purchase. The Claimant gave notice to the defendant that the failure to complete was being treated as a repudiation of the agreement and issued a writ against the defendant claiming for breach of contract. The claimant also applied for summary judgment contending that time was of the essence of completion. The defendant was ordered to make a reduced interim payment.

*R v Panel on Take-overs and Mergers, Ex parte Datafin plc and another*[1013]

Judicial Review of a decision of the Panel on Takeovers and Mergers: the claim alleged that the Panel had dismissed a complaint of an alleged breach of the code. The court declined to intervene.

[1012] [1989] 3 All ER 492
[1013] [1987] Q.B. 815



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*R v Panel on Take-Overs and Mergers ex parte Guinness plc*[1014]

Judicial Review of a decision of the Panel on Takeovers and Mergers regarding a procedural impropriety. The Panel had refused to adjourn a hearing of an alleged breach of the code. The court declined to intervene.

*R v The Panel on Takeovers and Mergers ex parte Mohamed Al Fayed*[1015]

Judicial Review of a decision of the Panel on Takeovers and Mergers regarding disciplinary proceedings against the applicants: the Panel and appellate committee of the Panel refused to adjourn the disciplinary proceedings when the applicants had a legitimate expectation that the proceedings would be adjourned. The court declined to intervene.

[1014] 1990] 1 Q.B. 146
[1015] [1992] BCLC 938



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# APPENDIX THREE

## LIST OF TABLES

Each table number corresponds to the chapter in which it was originally presented and the order in the chapter that it came. For example Table 4.1 is from chapter four and is the first table to appear in that chapter. Each table heading gives a brief explanation of what is contained in the table, but for further details see the specified chapter.

### Table 4.1

List of the typologies of complaints that parties to a takeover may have.

| | **Complaint** | |
|---|---|---|
| **Complainant** | **Target of Complaint** | **Substance of Complaint** |
| **1.** Target Directors | **1A.** Target Shareholders | **1Ai.** Identity of TS* |
| | | **1Aii.** Concert party arrangements |
| | **1B.** Fellow Target Director | **1Bi.** Failure to disclose information |
| | | **1Bii.** Merits of the bid |
| | | **1Biii.** Acting in concert with the Bidder |
| | | **1Biv.** Interest in bid |
| | **1C.** Bidder | **1Ci.** Breach of standstill clause |
| | | **1Cii.** Breach of confidentiality agreement |
| | | **1Ciii.** Failure to disclose information |
| | | **1Civ.** Conflict of interest |
| | | **1Cv.** Breach of timetable |
| | | **1Cvi.** Bidder pressured TS to sell shares |
| | | **1Cvii.** Extension of timetable |
| | | **1Cviii.** Takeover detrimental to long term plans of the TC** |
| | | **1Cix.** Breach of Code |
| | | **1Cx.** Misrepresented information |
| | | **1Cxi.** Value of bid |
| | | **1Cxii.** Failure to formalise bid |
| | | **1Cxiii.** Loss of employment |
| | | **1Cxiv.** Change to contract of employment |
| | 1D. Bidder/Government | **1Di.** Breach of competition laws |



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| | | |
|---|---|---|
| | | **1Dii.** TC is a 'national treasure' or 'jewel company' |
| | | **1Diii.** Takeover will have detrimental effect to UK economy |
| | 1E. Advisors | **1Ei.** Negligent advice |
| | 1F. Takeover Panel | **1Fi.** Decision or ruling |

| | **Complaint** | |
|---|---|---|
| **Complainant** | **Target of Complaint** | **Substance of Complaint** |
| 2. Target Shareholders | 2A. Target Director | 2Ai. TD*** misrepresented information |
| | | 2Aii. Failure to disclose information |
| | | 2Aiii. TD in conflict or not complying with the Code |
| | | 2Aiv. TD valuation of the share price |
| | | 2Av. TD advice on the merits of the bid |
| | | 2Avi. TD interest in bid |
| | | 2Avii. TD knew or ought to have known that the advice given to the shareholders by other professionals was negligent or misrepresentative |
| | | 2Aviii. TD issued new shares |
| | | 2Aix. TD knew or ought to have known that bidder would strip company of assets |
| | | 2Ax. TD knew or ought to have known that the takeover was detrimental |
| | 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority |
| | | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted |
| | | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder |
| | | 2Biv. New directors/majority have stripped company of assets |
| | 2C. Advisors | 2Ci. Negligent advice |



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| | Complaint | |
|---|---|---|
| **Complainant** | **Target of Complaint** | **Substance of Complaint** |
| 3. Bidding Company | 3A. Target Company | 3Ai. Breach of timetable |
| | | 3Aii. TC used takeover defence |
| | | 3Aiii. TC used a disproportionate defence |
| | | 3Aiv. Failure to disclose information |
| | | 3Av. TD refused to negotiate |
| | | 3Avi. Value of bid |
| | | 3Avii. TD misrepresent information |
| | | 3Aviii. TD advice to shareholders |
| | 3B. Advisors | 3Bi. Negligent advice |
| | 3C. Takeover Panel | 3Ci. Decision or ruling |
| 4. Bidding Shareholders | 4A. Bidding Directors | 4Ai. Takeover in not in the best interests of the BC**** |
| | | 4Aii. BD did not obtain best price for shares |
| | | 4Aiii. BD misrepresented information |
| | | 4Aiv. BD advice on merits of bid |
| | | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative |
| | 4B. Advisors | 4Bi. Negligent advice |

**Table 4.2**

Complaint type and corresponding UK cause of action.

| Complaint: Complainant: Target Directors | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 1A. Target Shareholders | 1Ai. Identity of TS | s.793, s.803 CA 2006 |
| | 1Aii. Concert party arrangements | s.793, s.803 CA 2006 |
| 1B. Fellow Target Director | 1Bi. Failure to disclose information | Duty of care; s.172, s.174 CA 2006 |
| | 1Bii. Merits of the bid | Duty of care; s.172, s.174 CA 2006 |
| | 1Biii. Acting in concert with the Bidder | Duty of care; s.172, s.173, s.174, s.175, s.177 CA 2006 |
| | 1Biv. Interest in bid | Duty of care; s.172, s.173, s.174, s.175, s.176, s.177 CA 2006 |



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| | | |
|---|---|---|
| 1C. Bidder | 1Ci. Breach of standstill clause | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) |
| | 1Cii. Breach of confidentiality agreement | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) |
| | 1Ciii. Failure to disclose information | |
| | 1Ciii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests |
| | 1Civ. Breach of timetable | |
| | 1Cv. Bidder pressured TS to sell shares | |
| | 1Cvi. Extension of timetable | |
| | 1Cvii. Takeover detrimental to long term plans of the TC | |
| | 1Cviii. Breach of Code | |
| | 1Cix. Misrepresented information | s.2(1) MA |
| | 1Cx. Value of bid | |
| | 1Cxi. Failure to formalise bid | |
| 1D. Bidder/Government | 1Di. Breach of competition laws | s.75 FTA |
| | 1Dii. TC is a 'national treasure' or 'jewel company' | |
| | 1Diii. Takeover will have detrimental effect to UK economy | |
| 1E. Advisors | 1Ei. Negligent advice | Duty of care; negligent misrepresentation |
| | 1Eii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests |
| 1F. Takeover Panel | 1Fi. Decision or ruling | Judicial Review |



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| Complaint: Complainant: Target Shareholders | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 2A. Target Director | 2Ai. TD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 |
| | 2Aii. Failure to disclose information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 |
| | 2Aiii. TD in conflict or not complying with the Code | |
| | 2Aiv. TD valuation of the share price | |
| | 2Av. TD advice on the merits of the bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 |
| | 2Avi. TD interest in bid | Derivative claim for breach of directors duties (s.172, s.173 s.174, s.175, s.176, s.177 CA 2006); Part 26; s.994 CA 2006 |
| | 2Avii. TD knew or ought to have known that the advice given to the shareholders by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 |
| | 2Aviii. TD issued new shares | Derivative claim for breach of directors duties (s.171 CA 2006), s.33, s.549 CA 2006 |
| | 2Aix. TD knew or ought to have known that bidder would strip company of assets | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 2Ax. TD knew or ought to have known that the takeover was detrimental | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority | |
| | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted | s.549 CA 2006 |
| | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder | |
| | 2Biv. New directors/majority have stripped company of assets | s.911B CA 2006 |



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| | | |
|---|---|---|
| 2C. Advisors | 2Ci. Negligent advice | Duty of care; negligent misrepresentation |
| | 2Cii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests |

| **Complaint: Complainant: Bidding Company** | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 3A. Target Company | 3Ai. Breach of timetable | |
| | 3Aii. TC used takeover defence | |
| | 3Aiii. TC used a disproportionate defence | |
| | 3Aiv. Failure to disclose information | Duty of care; s.90A FSMA |
| | 3Av. TD refused to negotiate | |
| | 3Avi. Value of bid | |
| | 3Avii. TD misrepresent information | |
| | 3Aviii. TD advice to shareholders | |
| 3B. Advisors | 3Bi. Negligent advice | Duty of care; negligent misrepresentation |
| 3C. Takeover Panel | 3Ci. Decision or ruling | Judicial Review |

| **Complaint: Complainant: Bidding Shareholders** | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 4A. Bidding Directors | 4Ai. Takeover in not in the best interests of the BC | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 4Aii. BD did not obtain best price for shares | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 4Aiii. BD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 4Aiv. BD advice on merits of bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) |
| | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 |
| 4B. Advisors | 4Bi. Negligent advice | Duty of care; negligent misrepresentation |



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**Table 4.3**

UK causes of action and corresponding takeover litigation rates over a 50 year period.

| | Cause of Action | No of Cases Litigated |
|---|---|---|
| **Companies Act 2006** | s.33 | 0 |
| | s.171 | 0 |
| | s.172 | 1 |
| | s.173 | 0 |
| | s.174 | 0 |
| | s.175 | 0 |
| | s.176 | 0 |
| | s.177 | 0 |
| | s.549 | 0 |
| | s.793 | 1 |
| | s.803 | 0 |
| | Part 26 | 1 |
| | s.911B | 0 |
| | s.994 | 3 |
| **Companies Act 1985** | s.216 | 3 |
| | s.459 (s.994 CA06) | 4 |
| **Companies Act 1948** | s.164/172 | 1 |
| | s.209 | 2 |
| **Fair Trading Act 1973** | s.75 | 1 |
| **Misrepresentation Act 1967** | s.2(1) | 1 |
| **Financial Services and Markets Act** | s.90 | 0 |
| **Contract Law (common law)** | Breach of contract | 1 |
| | Negligent misstatement | 4 |
| **Directors Duties (common law position pre Companies Act 2006)** | Improper purpose | 4 |
| | Duty to act in good faith | 3 |
| | Duty of Care | 0 |
| | Conflict of interest | 0 |
| **Fiduciary Duties (common law)** | Duty of care | 5 |
| | Duty to act in best interests | 0 |
| | Duty of confidence | 2 |



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| | | |
|---|---|---|
| | Conflict of interest | 3 |
| **Judicial Review** | | 3 |
| **Total (inc. common law directors duties)** | | 43 |

**Table 4.4**

Most common UK causes of action for takeover litigation.

| Cause of Action | Number of Takeover Litigation | Percentage of total cases recorded % |
|---|---|---|
| Common Law Fiduciary Duties | 10 | 23 |
| Directors Duties | 8 | 19 |
| Unfair Prejudice (s.994 CA06 & s.459 CA85) | 7 | 16 |
| Negligent Misstatement | 4 | 9 |

**Table 4.5**

UK takeover litigation rates compared to number of takeovers.

| Year | Number of Takeover Litigation | Number of Takeovers | Percentage % |
|---|---|---|---|
| 2015 | 0 | 49 | 0 |
| 2014 | 2 | 211 | 0.95 |
| 2013 | 1 | 326 | 0.31 |
| 2012 | 0 | 373 | 0 |
| 2011 | 1 | 564 | 0.18 |
| 2010 | 1 | 537 | 0.19 |
| **Total** | **5** | **2060** | **0.24** |



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**Table 4.6**

Number of UK takeover litigation per decade.

| Decade | Number of Takeover Litigation |
|---|---|
| 60's | 4 |
| 70's | 4 |
| 80's | 10 |
| 90's | 11 |
| 00's | 8 |
| 10's | 6 |
| **Total** | **43** |

**Table 4.7**

Instigators of UK takeover litigation.

| Instigator of Litigation | Number | Percentage % |
|---|---|---|
| Target Shareholder | 17 | 39.6 |
| Target Company | 6 | 14 |
| Target Director | 0 | 0 |
| Bidder | 15 | 34.8 |
| Other | 5 | 11.6 |

**Table 4.8**

Targets of UK takeover litigation.

| Target of Litigation | Number | Percentage % |
|---|---|---|
| Target Shareholder | 0 | 0 |
| Target Company | 17 | 39.6 |
| Target Director | 5 | 11.6 |
| Bidder | 10 | 23.2 |
| Other | 11 | 25.6 |



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**Table 4.9**

Outcomes of UK takeover litigation

| | Number | Percentage % |
|---|---|---|
| **Litigation Successful** | 12 | 28 |
| **Litigation Unsuccessful** | 31 | 72 |

**Table 4.10**

UK causes of action compared to Code provisions.

| **Complaint: Target Directors** | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 1A. Target Shareholder | 1Ai. Identity of TS | s.793, s.803 CA 2006 | Rule 5.4, Rule 8 |
| | 1Aii. Concert party arrangements | s.793, s.803 CA 2006 | Rule 9.1, Rule 8 |
| 1B. Fellow Target Director | 1Bi. Failure to disclose information | Duty of care; s.172, s.174 CA 2006 | Rule 20.1, Rule 23.1 |
| | 1Bii. Merits of the bid | Duty of care; s.172, s.174 CA 2006 | Rule 23.1, rule 20.1 |
| | 1Biii. Acting in concert with the Bidder | Duty of care; s.172, s.173, s.174, s.175, s.177 CA 2006 | Rule 16.2, Rule 24.5 |
| | 1Biv. Interest in bid | Duty of care; s.172, s.173, s.174, s.175, s.176, s.177 CA 2006 | Rule 16.2, Rule 24.5 |

| **Complaint: Target Directors** | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 1C. Bidder | 1Ci. Breach of standstill clause | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) | |
| | 1Cii. Breach of confidentiality agreement | Breach of contract (breach of conditions/repudiatory breach of contract/anticipatory breach) | Rule 20 |



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| | | | |
|---|---|---|---|
| | 1Ciii. Failure to disclose information | | Rule 8, Rule 20.1, Rule 23.1, Rule 24.2, Rule 24.3, Rule 25.3 |
| | 1Ciii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests | Rule 3.2 |
| | 1Civ. Breach of timetable | | Rule 31 |
| | 1Cv. Bidder pressured TS to sell shares | | Rule 16.1 |
| | 1Cvi. Extension of timetable | | Rule 31 |
| | 1Cvii. Takeover detrimental to long term plans of the target company | | Rule 24.2 |
| | 1Cviii. Breach of Takeover Regulations | | Breach of any Code rule |
| | 1Cix. Misrepresented information | s.2(1) MA 67 | Rule 19.1, 19.3 |
| | 1Cx. Value of bid | | |
| | 1Cxi. Failure to formalise bid | | Rule 2.7 |
| 1D. Bidder/Government | 1Di. Breach of competition laws | s.75 FTA 73 | |
| | 1Dii. TC is a 'national treasure' or 'jewel company' | | |
| | 1Diii. Takeover will have detrimental effect to UK economy | | |
| 1E. Advisors | 1Ei. Negligent advice | Duty of care; negligent misrepresentation | |
| | 1Eii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests | |
| 1F. Takeover Panel | 1Fi. Decision or ruling | Judicial Review | |



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| **Complaint: Target Shareholders** | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 2A. Target Director | 2Ai. TD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 | Rule 19.1, 19.3 |
| | 2Aii. Failure to disclose information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); Part 26; s.994 CA 2006 | Rule 23.1, Rule 20.1 |
| | 2Aiii. TD in conflict or not complying with the Code | | A number of Code rules could be breached |
| | 2Aiv. TD valuation of the share price | | Rule 3.1 |
| | 2Av. TD advice on the merits of the bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | Rule 23.1, Rule 20.1 |
| | 2Avi. TD interest in bid | Derivative claim for breach of directors duties (s.172, s.173 s.174, s.175, s.176, s.177 CA 2006); Part 26; s.994 CA 2006 | Rule 16.2, Rule 24.5 |
| | 2Avii. TD knew or ought to have known that the advice given to the shareholders by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | Rule 19.1, 19.3 |
| | 2Aviii. TD issued new shares | Derivative claim for breach of directors duties (s.171 CA 2006), s.33, s.549 CA 2006 | Rule 21 |
| | 2Aix. TD knew or ought to have known that bidder would strip company of assets | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Rule 23.1 |
| | 2Ax. TD knew or ought to have known that the takeover was detrimental | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | Rule 23.1 |



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| Complaint: Target Shareholders | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority | | |
| | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted | s.549 CA 2006 | |
| | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder | | |
| | 2Biv. New directors/majority have stripped company of assets | s.911B CA 2006 | |
| 2C. Advisors | 2Ci. Negligent advice | Duty of care; negligent misrepresentation | |
| | 2Cii. Conflict of interest | Fiduciary conflict of interest, duty of confidence, duty of loyalty & duty to act in best interests | |

| Complaint: Bidding Company | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 3A. Target Company | 3Ai. Breach of timetable | | Rule 31 |
| | 3Aii. TC used takeover defence | | Rule 21 |
| | 3Aiii. TC used a disproportionate defence | | Rule 21 |
| | 3Aiv. Failure to disclosure of information | Duty of care; s.90A FSMA 2000 | Rule 8, Rule 20.1, Rule 25.3 |
| | 3Av. TD refused to negotiate | | |
| | 3Avi. Value of bid | | |
| | 3Avii. TD misrepresent information | | |
| | 3Aviii. TD advice to shareholders | | |



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| | | | |
|---|---|---|---|
| 3B. Advisors | 3Bi. Negligent advice | Duty of care; negligent misrepresentation | |
| 3C. Takeover Panel | 3Ci. Decision or ruling | Judicial Review | |

| **Complaint: Bidding Shareholders** | | | |
|---|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** | **Code Provision** |
| 4A. Bidding Directors | 4Ai. Takeover in not in the best interests of the BC | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | |
| | 4Aii. BD did not obtain best price for shares | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | |
| | 4Aiii. BD misrepresented information | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | |
| | 4Aiv. BD advice on merits of bid | Derivative claim for breach of directors duties (s.172, s.174 CA 2006) | |
| | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative | Derivative claim for breach of directors duties (s.172, s.174 CA 2006); s.994 CA 2006 | |
| 4B. Advisors | 4Bi. Negligent advice | Duty of care; negligent misrepresentation | |



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**Table 4.11**

Number of formal rulings made by the Panel and the corresponding rule breach.

| Code Rule | Rulings* |
|---|---|
| 2.7 | 22 |
| 5.4 | 0 |
| 8 | 1 |
| 9.1 | 3 |
| 16.1 | 0 |
| 16.2 | 0 |
| 19.1 | 0 |
| 19.3 | 1 |
| 20 | 0 |
| 20.1 | 0 |
| 21 | 0 |
| 23.1 | 0 |
| 24.5 | 0 |
| 25.3 | 0 |
| 31 | 0 |
| **Total** | **27** |

**Table 4.12**

The number of formal rulings the Panel has made per decade.

| Year | No of Rulings |
|---|---|
| 2015 | 0 |
| 2014 | 2 |
| 2013 | 3 |
| 2012 | 5 |
| 2011 | 14 |
| 2010 | 11 |
| **Total** | **35** |



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**Table 4.13**

The number of Panel rulings compared to the total number of completed takeovers.

| Year | No of Rulings | No of Takeovers | Percentage % |
|---|---|---|---|
| 2015 | 0 | 49 | 0 |
| 2014 | 2 | 211 | 0.95 |
| 2013 | 3 | 326 | 0.92 |
| 2012 | 5 | 373 | 1.34 |
| 2011 | 14 | 564 | 2.48 |
| 2010 | 11 | 537 | 2.05 |
| **Total** | **35** | **2060** | **1.75** |

**Table 5.1**

List of US rules that may be breached by parties to a takeover.

| Regulation | Section/Rule | Description |
|---|---|---|
| SEA* | s.13(a) | Requires that issuers whose securities are registered with the Commission pursuant to s.12 SEA file with the Commission accurate annual reports |
| SEA | s.13(d) | Persons owning >5% of stock must file holdings on Schedule 13D report with the SEC within 10 days of purchase |
| SEA | s.13(d)(3) | Requires that when two or more persons act as a group for the purpose of acquiring, holding or disposing of shares they will be deemed a "person" (acting in concert), such a group must file a Schedule 13D report if exceed 5% threshold |
| SEA | s.13(e) | Regulates self-tender offers |
| SEA | s.13(f) | All institutional Investors must disclose ownership regardless of number of stock owned |
| SEA | s.14(a) | Rules on proxy solicitation |



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| | | |
|---|---|---|
| SEA | s.14(d) | Regulates tender offers generally (rules on disclosure and procedure) |
| SEA | s.14(e) | Regulates unlawful tender offer practices (prohibits fraud) |
| SEC | 12b-20 | Requires that reports required under s.13(a) contain any additional information necessary to ensure that the required statements in the reports are not, under the circumstances, materially misleading |
| SEC | 13a-11 | Every registrant subject to s.13(a) shall file a current report on Form 8-K within the period specified in that form |
| SEC | 14a-3, 14a-8, 14a-12 | Rules on exempt communications from definition of solicitation regarding proxy rules |
| SEC | 14d-1 | Regulates the scope and definitions of s.14(d) and s.14(e), including required mandatory disclosures under these provisions |
| SEC | 14d-2 | Governs the commencement of an offer |
| SEC | 14d-5 | Dissemination of certain tender offers by the use of stockholder lists and security position listings. |
| SEC | 14d-6 | Disclosure requirements with respect to tender offers |
| SEC | 14d-7 | Withdrawal rights: any person who has deposited securities pursuant to a tender offer has the right to withdraw any such securities during the period such offer request or invitation remains open |
| SEC | 14d-9 | Regulates target directors' disclosure statement, on the 14D-9 form, to target shareholders |
| SEC | 14d-9(f) | Target board must file 14D-9 Form with SEC disclosing reasons for boards position on an offer |



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| SEC | 14d-10 | If the bidder increases offer, target shareholders who have already accepted the previous offer are also entitled to the increased offer |
|---|---|---|
| SEC | 14e-1 | Bidder must keep offer open for at least 20 business days |
| SEC | 14e-2 | Target Directors must disclosure their position on an offer to shareholders within 10 business days of commencement of the offer |

**Table 6.1**

US corresponding cause of action for common complaints.

| **Complaint** | **Cause of Action** |
|---|---|
| Non-disclosure of acquisition above 5% | s.13(d) SEA |
| Material misrepresentations and omissions in proxy statements | s.14(a) SEA |
| Breach of the federal procedural and disclosure requirements for a tender offer | s.14(d) SEA |
| Misrepresentations and omissions in connection with the offer | s.14(e) SEA |
| Mandatory SEC filings have not been made | SEC Rule 14d-1 |
| Target has not responded to the offer by filing the information required by SEC within 10 business days | SEC Rule 14d-9 |
| The offer has not been kept open for the minimum of 20 business days | SEC Rule 14e-1 |



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**Table 6.2**

US cause of action to pursue the typology of complaints as identified in chapter four.

| **Complaint: Complainant: Target directors** | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 1A. Target Shareholders | 1Ai. Identity of TS | s.13(d) SEA |
| | 1Aii. Concert party arrangements | s.13(d) SEA |
| 1B. Fellow Target Director | 1Bi. Failure to disclose information | s.13(a), s.13(d) s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor |
| | 1Bii. Merits of the bid | Directors duty of loyalty and duty of care |
| | 1Biii. Acting in concert with the Bidder | Directors duty of loyalty, duty of candor and duty of care |
| | 1Biv. Interest in bid | Directors duty of loyalty, duty of candor and duty of care |
| **Complaint: Complainant: Target directors (continued)** | | |
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 1C. Bidder | 1Ci. Breach of standstill clause | Breach of contract (specific to each governing State) |
| | 1Cii. Breach of confidentiality agreement | Breach of contract (specific to each governing State) |
| | 1Ciii. Failure to disclose or misrepresented information | s.13(d), s.14(a), s.14(e) SEA ; SEC Rule 14d-1 |
| | 1Ciii. Conflict of interest | Directors duty of care |
| | 1Civ. Breach of timetable | SEC Rule 14e-1 |
| | 1Cv. Bidder pressured TS to sell shares | |
| | 1Cvi. Extension of timetable | |
| | 1Cvii. Takeover detrimental to long term plans of the target company | |
| | 1Cviii. Breach of Regulations | s.13(d), s.13(e), s.14(a), s.14(d), s.14(e) SEA; SEC Rule 14d-1 |
| | 1Cix. Misrepresented information | s.13(a), s.14(d) SEA |
| | 1Cx. Value of bid | |



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| | | |
|---|---|---|
| | 1Cxi. Failure to formalise bid | |
| 1D. Bidder/Government | 1Di. Breach of competition laws | s.7 The Clayton Antitrust Act 1914 |
| | 1Dii. TC is a 'national treasure' or 'jewel company' | |
| | 1Diii. Takeover will have detrimental effect to the economy | |
| 1E. Advisors | 1Ei. Negligent advice | Duty of care |
| | 1Eii. Conflict of interest | Duty of care |
| 1F. Regulating Body | 1Fi. Decision or ruling | Judicial Review |

| **Complaint: Complainant: Target Shareholders** | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 2A. Target Director | 2Ai. TD misrepresented information | s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor |
| | 2Aii. Failure to disclose information | s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor |
| | 2Aiii. TD in conflict or not complying with takeover regulations | |
| | 2Aiv. TD valuation of the share price | Directors duty of loyalty and duty of care |
| | 2Av. TD advice on the merits of the bid | s.14(d) SEA; SEC Rule 14d-5, 14d-6; Directors duty of candor and the duty of loyalty |
| | 2Avi. TD interest in bid | s.14(d) SEA; Directors duty of loyalty, duty of candor and duty of care |
| | 2Avii. TD knew or ought to have known that the advice given to the shareholders by other professionals was negligent or misrepresentative | Directors duty of loyalty, duty of care and duty of candor |
| | 2Aviii. TD issued new shares | |
| | 2Aix. TD knew or ought to have known that bidder would strip company of assets | |



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| | | |
|---|---|---|
| | 2Ax. TD knew or ought to have known that the takeover was detrimental | Directors duty of loyalty, duty of care and duty of candor |
| 2.B Bidder/New Directors | 2Bi. Long-term plans have been unnecessarily disregarded by the new directors/majority | Directors duty of loyalty and duty of care; Breach of controlling shareholders duty |
| | 2Bii. New directors issues shares (after takeover), and as a result remaining target shareholders vote is diluted | |
| | 2Biii. TS who are unable to take advantage of sell-out rule, but are affected by a new majority want their shares to be bought by the bidder | |
| | 2Biv. New directors/majority have stripped company of assets | |
| 2C. Advisors | 2Ci. Negligent advice | Duty of care |
| | 2Cii. Conflict of interest | Duty of care |
| **Complaint: Complainant: Bidding Company** | | |
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 3A. Target Company | 3Ai. Breach of timetable | SEC Rule 14d-9 (recommendations or solicitations by the target company or others) |
| | 3Aii. TC used takeover defence | Directors duty of loyalty and duty of care |
| | 3Aiii. TC used a disproportionate defence | Directors duty of loyalty and duty of care |
| | 3Aiv. Failure to disclosure information | s.13(a), s.14(d) SEA; SEC Rules 12b-20 13a-11, 14d-9; Directors duty of candor |
| | 3Av. TD refused to negotiate | Directors duty of loyalty and duty of care |
| | 3Avi. Value of bid | s.14(a), s.14(d) SEA |
| | 3Avii. TD misrepresented or did not disclose information | s.14(a) SEA; SEC Rule 14D-9 |
| | 3Aviii. TD advice to shareholders | |
| 3B. Advisors | 3Bi. Negligent advice | Duty of care |



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| 3C. Regulating Body | 3Ci. Decision or ruling | Judicial Review |
|---|---|---|

| **Complaint: Complainant: Bidding Shareholders** | | |
|---|---|---|
| **Target of Complaint** | **Substance of Complaint** | **Potential Cause of Action** |
| 4A. Bidding Directors | 4Ai. Takeover in not in the best interests of the BC | Directors duty of loyalty and duty of care |
| | 4Aii. BD did not obtain best price for shares | Directors duty of loyalty and duty of care |
| | 4Aiii. BD misrepresented information | Directors duty of loyalty, duty of care and duty of candor |
| | 4Aiv. BD advice on merits of bid | Directors duty of loyalty, duty of care and duty of candor |
| | 4Av. BD knew or ought to have known that the advice given to the BS by other professionals was negligent or misrepresentative | Directors duty of loyalty, duty of care and duty of candor |
| 4B. Advisors | 4Bi. Negligent advice | Duty of care |

**Table 6.2**

US takeover litigation rates taken from Krishnan et al's study

| | % |
|---|---|
| Litigation in high value deals (>$80mil) | 18.73 |
| Litigation in small value deals (<$80mil) | 5.09 |



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**Table 7.1**

Typology of complaints: comparing UK and US available causes of action. Highlighting only those which do not have a corresponding right of action in the UK (table is a condensation of previous table 4.2 and 6.2.

| | **Complaint** | | **Potential Cause of Action** | |
|---|---|---|---|---|
| **Complainant** | **Target of Complaint** | **Substance of Complaint** | **UK** | **US** |
| Target Directors | Bidder | 1Ciii. Failure to disclose or misrepresented information | | s.13(d), s.14(a), s.14(e) SEA ; SEC Rule 14d-1 |
| | | 1Civ. Breach of timetable | | SEC Rule 14e-1 (minimum tender offer period) |
| | | 1Cviii. Breach of takeover regulations | | s.13(d), s.13(e), s.14(a), s.14(d), s.14(e) SEA; SEC Rule 14d-1 |
| Bidding Company | Target Company | 3Ai. Breach of timetable | | SEC Rule 14d-9 (recommendations or solicitations by the target company or others) |
| | | 3Avii. TD misrepresented or did not disclose information | | s.14(a) SEA; SEC Rule 14D-9 |



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**Table 8.1**

Process of the single-step merger.

| Single-Step Transaction | |
|---|---|
| **Day(s)** | **Activity** |
| 1 | Announcement |
| 2 to 15 | Prepare proxy statement (Target with the Bidder's input) |
| 16 | File preliminary proxy materials with SEC |
| 26 to 50 | Receive and resolve SEC comments |
| 55 | Print and mail proxy materials |
| 90 | Target shareholders' meeting to vote on merger |
| 91 | Complete merger (provided requisite vote is obtained) |
| | *Bidder now controls and owns 100% of Target* |

*Materials taken from 'A Guide to Takeovers in the United States', Clifford Chance Guide (2010)

**Table 8.2**

Process of the two-step merger.

| Two-Step Transaction | |
|---|---|
| **Day(s)** | **Activity** |
| 1 | Announcement |
| 2 to 15 | Prepare Offer to Purchase and Schedule 14D-9 (Target) |
| 15 | Commence tender offer; file definitive tender offer materials with SEC; mail materials to Target Shareholders |
| 15 to 43 | Address any comments provided by SEC staff |
| 43 | Close tender offer (if minimum tender offer and other conditions satisfied) |
| | *Bidder now controls Target* |
| 47 | If Bidder now owns at least 90% of Target's outstanding shares - file short-form merger certificate |
| | *Bidder now owns 100% of Target* |
| 47 to 77 | If Bidder owns less than 90% of Target's outstanding shares - prepare and file proxy materials with SEC relating to "squeeze-out" merger |
| 88 | Mail proxy materials |
| 108 | Target shareholder meeting to vote on 'squeeze out' merger |
| 109 | Complete merger |
| | *Bidder now owns 100% of Target* |

*Materials taken from 'A Guide to Takeovers in the United States', Clifford Chance Guide (2010)



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