THE AVAILABILITY OF TAKEOVER DEFENSES AND DEAL PROTECTION DEVICES FOR ANGLO-AMERICAN TARGET COMPANIES

BY ALBERT O. "CHIP" SAULSBURY, IV*

ABSTRACT

On September 19, 2011 the United Kingdom's Panel on Takeovers and Mergers (the "Panel") enacted amendments to the City Code on Takeovers and Mergers (the "Takeover Code"). These amendments will have a significant impact on the manner in which companies in the U.K. engage in mergers and acquisitions ("M&A") and will amplify the differences between British and American deal activity. The board of directors for U.S. target companies can use takeover defenses to divert hostile offers into a negotiated acquisition process, which generates more negotiating power and ultimately allows the board to maximize shareholder value in M&A transactions. During negotiations, directors also have the ability to incorporate provisions in the merger agreement known as deal protection devices, which ultimately lead to an increased price and higher premiums for shareholders. The substantive rules developed through the Delaware common law and the Delaware General Corporation Law place the ultimate power and authority in the hands of the board of directors during the sale of the company. Directors of target companies in the U.K. are not vested with the same ability to divert offers into a negotiation process. Instead, takeover defenses are strictly prohibited in the U.K., and the Panel's recent revisions to the Takeover Code prohibit the use of deal protection devices. By eliminating takeover defenses and deal protection devices, the Takeover Code significantly reduces the board's negotiating power.

This Article argues that the availability of takeover defenses and deal protection devices under Delaware corporate law gives directors of U.S. target companies more negotiating power and allows them to generate higher premiums for shareholders in M&A transactions compared to their colleagues in the U.K. The Delaware courts' use of a malleable

*Associate at Fishman Haygood Phelps Walmsley Willis & Swanson, LLP, New Orleans, Louisiana. J.D., Louisiana State University; B.A., Washington & Lee University. The author thanks Professor Christina M. Sautter and John Donofrio for their comments on earlier drafts. All views and errors herein are solely attributable to the author.

Electronic copy available at: http://ssrn.com/abstract=1906522

reasonableness standard allows directors to adapt to the unique circumstances surrounding each deal, while holding directors accountable under a fiduciary duty analysis. This is in stark contrast to the bright line rules of the U.K.'s recently amended Takeover Code, which strip the board of any ability to use takeover defenses and deal protection devices. Instead, the authority to decide on the merits of a transaction in the U.K. rests solely with the shareholders of the company, which prohibits directors from negotiating higher priced deals.

TABLE OF CONTENTS

I. INTRODUCTION 117
II. DIFFERENT APPROACHES: REGULATION OF MERGERS AND ACQUISITIONS 118
A. *United States: Delaware Common Law* 118
1. Delaware's Regulatory Scheme 119
2. The Delaware Court of Chancery 119
B. *United Kingdom: The Takeover Panel and the City Code on Takeovers and Mergers* 120
1. Emergence of the Panel on Takeovers and Mergers 122
2. Enforcement of the Takeover Code 124
C. *Compatibility of Regulatory Regimes with Respective Substantive Rules* 127
III. SIMILAR REQUIREMENTS: DIRECTOR APPROVAL AND THE BUSINESS JUDGMENT RULE 129
A. *Director Approval and Advisability Requirements* 129
B. *General Duty of Care and the Business Judgment Rule* 131
1. United States: *Smith v. Van Gorkom* 131
2. United Kingdom: Codified Process Rules 133
IV. AVAILABILITY OF TAKEOVER DEFENSES 135
A. *United States: Takeover Defenses Permitted* 135
1. *Unocal*, *Moran*, and the Emergence of the Poison Pill 135
2. *Revlon*: When Takeover Defenses are Prohibited 139
B. *United Kingdom: Takeover Defenses Strictly Prohibited* 141
C. *Greater Director Control Encourages Negotiation and Increases Price* 142
V. AVAILABILITY OF DEAL PROTECTION DEVICES 146
A. *United States: Deal Protection Analyzed under the Unocal Standard* 151
B. *United Kingdom: Recent Amendments Prohibit Deal Protection Devices* 154
C. *Deal Protection Devices Increase Shareholder Premiums* 156

Electronic copy available at: http://ssrn.com/abstract=1906522

VI. CONCLUSION 160

I. INTRODUCTION

Dams are often built to divert river water to generate hydroelectric power, irrigate farmland, or for other purposes that benefit the community. After being diverted, the water is released and then flows downriver. In a similar fashion, the board of directors for United States target companies (and more specifically, Delaware target companies) can use takeover defenses to divert hostile offers into a negotiated acquisition process, which generates more negotiating power and ultimately maximizes shareholder value.[1] While in the negotiating process, directors also have the ability to negotiate provisions known as deal protection devices, which, as empirical studies show, lead to an increased price and higher premiums for shareholders in the majority of deals.[2]

Directors of target companies in the United Kingdom do not have the same ability to divert offers into a negotiation process. Instead, takeover defenses are strictly prohibited in the U.K.,[3] and in July 2011, the British regulatory authorities banned directors' use of deal protection devices.[4] This Article argues that the ability to use deal protection devices and takeover defenses gives directors of U.S. target companies more negotiating power and control over the sale of the company, which ultimately leads to increased premiums for shareholders. This argument finds support from practitioners, legal and financial scholars, and several empirical studies. Part II of this Article provides a background of the different regulatory approaches taken in the United States and the United Kingdom. Part III briefly discusses the similar director approval requirements and business judgment rule standard in the two jurisdictions. Finally, Parts IV and V discuss the availability of takeover defenses and deal protection devices respectively, and conclude that the ability of U.S. directors to use these measures ultimately benefits companies and their shareholders.

---

[1] *See infra* Part IV.C.
[2] *See infra* Part V.C.
[3] *See infra* Parts IV.B, V.B.
[4] *See infra* text accompanying note 271.

II. DIFFERENT APPROACHES: REGULATION OF MERGERS AND ACQUISITIONS

The United States and the United Kingdom take very different approaches to regulating mergers and acquisitions ("M&A"). The U.K. adopted a codified system of rules that is primarily enforced through a regulatory agency.[5] By contrast, the rules regulating deal activity in the U.S. have largely been developed through common law derivative suit litigation within the Delaware courts.[6]

A. *United States: Delaware Common Law*

For a number of reasons, most of the United States' largest corporations incorporate in Delaware, including "[m]ore than 50% of all U.S. publicly-traded companies and 63% of the Fortune 500."[7] Therefore, Delaware law governs the fiduciary duties of directors in the majority of M&A transactions involving public companies in the U.S., making it "by far the most important source of regulation."[8] The Securities and Exchange Commission ("SEC") does regulate tender offers and merger activity, but its regulations focus on disclosures and not necessarily the decisions made by the board of directors.[9] Therefore, the primary source of regulation for target directors' decision-making in M&A comes from decisions of the Delaware courts in derivative suit litigation and lawsuits seeking preliminary injunctions of deals.[10]

---

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

[6]*Id.*

[7]DELAWARE DIVISION OF CORPORATIONS, http://corp.delaware.gov/ (last updated Dec. 12, 2011).

[8]Armour & Skeel, *supra* note 5, at 1735. Delaware corporate law is very influential and also affects companies incorporated in other states because courts frequently apply decisions of the Delaware courts to their own corporate law. *See, e.g.*, Burcham v. Unison Bancorp, Inc., 77 P.3d 130, 149-50 (Kan. 2003) (applying Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946 (Del. 1985) to review Unison's use of a poison pill); Blake v. Friendly Ice Cream Corp., 2006 WL 2714976, at *1-*2 (Mass. Super. Ct. Aug. 24, 2006) (applying the demand futility rules from Aronson v. Lewis, 473 A.2d 805 (Del. 1984)); Sound Infiniti, Inc. v. Snyder, 237 P.3d 241, 244-45 (Wash. 2010).

[9]Armour & Skeel, *supra* note 5, at 1743, 1780.

[10]*Id.* at 1743.

1. Delaware's Regulatory Scheme

Under Section 141(a) of the Delaware General Corporation Law ("DGCL"), the business and affairs of the corporation are managed under the direction of the board of directors.[11] In conjunction with this grant of power, Delaware common law imposes fiduciary duties on the directors to the corporation and its shareholders.[12] Therefore, in the context of mergers and acquisitions, the directors of target companies owe a fiduciary duty of care to the shareholders during the sale of the company.[13] Under Delaware law, shareholders can challenge the directors' decisions by filing a derivative suit, which allows "shareholders to sue in the corporation's name where those in control of the company refused to assert a claim belonging to it."[14] In these actions, shareholders bring a claim on behalf of the company asserting that mismanagement or negligence by directors caused economic injury to the company.[15] These lawsuits are filed in the Delaware Court of Chancery and ultimate appellate authority lies with the Delaware Supreme Court.

2. The Delaware Court of Chancery

The Delaware Court of Chancery is considered the nation's "most sophisticated and efficient corporate law arbiter."[16] This is true both because of the frequency with which the members of the Court of Chancery review corporate law issues and their experience and education prior to reaching the bench.[17] The Court of Chancery judges continue to keep in touch with

---

[11] DEL. CODE. ANN. tit. 8, § 141(a) (2011).

[12] *See* Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).

[13] *See infra* Part III.B.1.

[14] *Aronson*, 473 A.2d at 811; *see also* DEL. CH. CT. R. 23.1.

[15] *Aronson*, 473 A.2d at 811.

[16] Armour & Skeel, *supra* note 5, at 1743.

[17] *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1102 (1997) ("[A] substantial number of the [Court of Chancery] judges are drawn from the very world at issue, that is, they are experienced and respected practitioners of Delaware corporate law."). For example, Chancellor Leo Strine graduated *magna cum laude* from the University of Pennsylvania Law School and practiced as a corporate litigator at Skadden, Arps, Slate, Meagher & Flom, which is one of the leading corporate law firms in the world. JUDICIAL OFFICERS OF THE COURT OF CHANCERY, DELAWARE STATE COURTS, http://courts.delaware.gov/chancery/judges.stm (last visited Jan. 1, 2012). Vice Chancellor Travis Laster graduated as class valedictorian from the University of Virginia School of Law and was a member of the *Virginia Law Review*. *Id.* Before his appointment, Vice Chancellor Laster practiced at a corporate law boutique that specialized in high stakes litigation involving Delaware corporations and other business entities, and he advised on transactional matters that carried a significant risk of litigation. *Id.* The other

modern trends in the market, "compar[ing] notes, often over lunch, about emerging corporate law issues, which enables them to begin mulling over new developments long before a particular dispute arises."[18]

Even though most state trial courts do not publish opinions, because of the Court of Chancery's influence on corporate law, the majority of its opinions are published and available for review by directors and attorneys representing corporations.[19] The opinions are often extremely long and detailed.[20] Given the complexity of the deals involved, and the court's thorough analysis of all of the issues, lengthy opinions are necessary in many circumstances. The court "do[es] this, in part, because of the possibility that the Opinion[s] may serve as guidance for future officers and directors—not only of [the company currently involved in the litigation], but of other Delaware corporations."[21] The Court of Chancery will often critique the performance of directors, even those who have not violated their fiduciary duties, in order to offer guidance and establish best practices for other directors in future deals.[22] The court's instructive approach is extremely helpful for providing directors with guidance when faced with difficult issues surrounding future deal activity.[23] As discussed below, this detailed analysis is unique to the American system, and directors of British targets do not receive similar guidance.

B. *United Kingdom: The Takeover Panel and the City Code on Takeovers and Mergers*

In stark contrast to Delaware, the powers and duties of British target company directors engaged in M&A deals are not defined through common law derivative actions.[24] Much of the reason for this stark contrast stems

---

Vice Chancellors have equally impressive résumés and experience. *See id.*

[18]Armour & Skeel, *supra* note 5, at 1749.

[19]*See, e.g.*, *In re* Walt Disney Deriv. Litig., 907 A.2d 693, 698 (Del. Ch. 2005); *see also* William J. Carney, George B. Shepherd & Joanna M. Shepherd, *Delaware Corporate Law: Failing Law, Failing Markets*, *in* THE LAW AND ECONOMICS OF CORPORATE GOVERNANCE: CHANGING PERSPECTIVES 23, 42 n.75 (Alessio M. Pacces ed., 2010) (noting that, unlike Delaware, "most state trial courts do not publish opinions").

[20]For example, in the recent case of Air Prods. & Chemicals, Inc. v. Airgas, Inc.16 A.3d 48 (Del. Ch. 2011), the Court of Chancery issued an eighty-one page opinion just seven days after the case was submitted. *See id*.

[21]*Disney*, 907 A.2d at 698.

[22]*See* Armour & Skeel, *supra* note 5, at 1749.

[23]*Id.*

[24]*See* James Barabas & Sarah Trapani, *Changes to English Company Law: Directors' Duties*, INSIGHTS, Feb. 2008, at 3, *available at* http://tinyurl.com/ChangesToEnglish ("Actions by shareholders (derivative actions) have been hard to bring before the English Courts."); *see also*

from the differences in the legal professions in the two countries and the greater financial incentive for U.S. attorneys to bring derivative actions, as compared to their colleagues in the U.K.[25] Also, institutional investors in the U.K. have not taken an active role in bringing derivative actions.[26] These factors have resulted in a significantly lower amount of deals being challenged through derivative suits in the U.K. compared to the U.S.

From 1990 to 2005, there were 312 hostile takeover bids of publicly traded target companies announced in the United States.[27] Of these bids, 106, or 33.9%, were litigated through derivative suits.[28] These numbers were significantly lower in the U.K., where only two of the 187 hostile takeover bids were litigated, or 0.1%.[29] The difference in the legal profession in the U.K., however, is not the sole driving force behind the lower percentage of derivative suits challenging M&A activity; rather, the statutory authority in place and the methodology of the regulatory body are also responsible for this trend.[30]

Armour & Skeel, *supra* note 5, at 1748-49 (noting that "[t]he United Kingdom's regulatory regime is proactive in its response to market developments" by assessing recent developments and making amendments to the Takeover Code, whereas "U.S. courts make rules in a way that is essentially reactive" by pronouncing new rules as a result of litigation that has derived from changes in the marketplace).

[25]In the United States, derivative suit litigation is largely driven by the incentive of the plaintiffs' bar to obtain contingency fees. *See* Cindy A. Schipani, *Corporate Governance and Shareholder Remedies: The US Experience and Australia's Proposals for Reform*, 6 BOND L. REV. 28, 28 (1994) (noting that shareholder litigation is more prominent in the U.S. due to "the ability of shareholders to retain legal counsel on a contingency fee basis, the rules requiring the corporation to pay the shareholder's attorney's fees, and the shareholder derivative suit mechanism"); Geoffrey Miller, *Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England*, 1998 COLUM. BUS. L. REV. 51, 67-68 (1998). Pursuant to Rule 2.04 of the Solicitors' Code of Conduct, attorneys in the U.K. may not enter into contingency fee arrangements. SOLICITORS' CODE OF CONDUCT R. 2.04 (2007) ("You must not enter into an arrangement to receive a contingency fee for work done in prosecuting or defending any contentious proceedings before a court of England . . . ."). Therefore, the financial incentive to obtain large contingency fees, which drives derivative actions for directors' breach of fiduciary duties in the Delaware courts, is not present in the U.K.

[26]*See* Miller, *supra* note 25, at 63 (stating that institutional investors in England "do not want to incur the costs and inconvenience of derivative litigation, which ties up senior fund managers' time, results in costs that cannot easily be passed on to fund clients, and invites free riding by other shareholders who do not contribute to the litigation").

[27]Armour & Skeel, *supra* note 5, at 1748, Table 2.

[28]*Id.*

[29]*Id.*

[30]Armour & Skeel, *supra* note 5, at 1744-45.

1. Emergence of the Panel on Takeovers and Mergers

Instead of relying on the common law as developed by the court system, British professionals involved in M&A formed a system of self-regulation, and institutional investors have played a significant role in shaping this system.[31] Historically, British institutional investors have taken a passive approach regarding governance issues for individual companies and instead choose to move on and sell their shares.[32] However, they have played an active role in dictating market-wide trends by intervening significantly in the regulatory process, including the formation of the Panel on Takeover and Mergers (the "Takeover Panel" or "Panel").[33]

In its current form, the Takeover Panel is composed of up to thirty-five members from major financial and business institutions, and its composition, according to its website, "giv[es] it an unrivalled expertise in takeovers and securities markets."[34] Certain constituencies have the ability to directly appoint Panel members, including groups that represent the British financial sector[35] and even groups that directly represent classes of institutional investors.[36] Once appointed to the Takeover Panel, its members are charged with enforcing a codified system of rules known as the "City Code on Takeover and Mergers" (the "Takeover Code" or "Code").[37]

The Takeover Code "is concerned with regulating takeover bids and merger transactions."[38] It was drafted "principally to ensure that shareholders in an offeree company are treated fairly and are *not denied an opportunity to decide* on the merits of a takeover."[39] The main concern is not the financial or commercial advantages or disadvantages of a deal; instead, the Takeover

---

[31]*Id.* at 1730 ("In the United Kingdom, the self-regulatory system was orchestrated principally by the community of investment bankers and institutional investors, all of whom regularly rub shoulders in the 'City,' the one-square-mile district where London's business community is located.").

[32]*Id.* at 1770.

[33]*Id.* at 1729, 1771.

[34]PANEL MEMBERSHIP, THE TAKEOVER PANEL, http://www.thetakeoverpanel.org.uk/structure/panel-membership#membership (last visited Jan. 1, 2012).

[35]These groups include: Association for Financial Markets in Europe; Association of Private Client Investment Managers and Stockbrokers; British Bankers' Association; Institute of Chartered Accountants in England and Wales; and Investment Management Association. *Id*.

[36]These groups include: Association of British Insurers; Association of Investment Companies; and National Association of Pension Funds. *Id.*

[37]*See* THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER PANEL, http://www.thetakeoverpanel.org.uk/ (last visited Jan. 1, 2012).

[38]TAKEOVER CODE intro., § 3(b), at A5 (Panel of Takeovers & Mergers 2011).

[39]*Id.* § 2(a), at A1 (emphasis added).

Code leaves these decisions to the target company's shareholders.[40] Institutional investors played a major role in shaping this policy:

> Institutional investors were involved at every stage of the drafting of the Code, right from its beginnings as the *Notes*. Because institutional investors have a clear interest in rules that maximize expected gains to shareholders, it is not surprising that the emergence of a pro-shareholder approach to takeover regulation coincided with the emergence of institutional investors as a significant force in British share ownership.[41]

As discussed below, this general policy of vesting shareholders with decision-making authority drives much of the Code's substantive rules.[42]

The Takeover Code is most concerned with the process that should take place during deals. It is intended to provide "an orderly framework within which takeovers are conducted."[43] The Code lists six "General Principles" that set forth its primary policies.[44] These principles are "expressed in broad general terms and the Code does not define the precise extent of, or the limitations on, their application."[45] Instead, "[t]hey are applied in accordance with their spirit in order to achieve their underlying purpose."[46] Proponents argue that this system allows the Panel to "adjust its regulatory responses both to the particular parties before it, and to the changing dynamics of business."[47]

The Code also provides bright line rules that govern target directors' activity during the sale of a company, including certain disclosure[48] and advisability[49] requirements, and also standards of conduct for directors

---

[40] *Id.*

[41] Armour & Skeel, *supra* note 5, at 1771.

[42] *See infra* Parts IV.B, V.B.

[43] TAKEOVER CODE intro., § 2(a), at A1.

[44] *See id.* at B1 (listing the six general principles).

[45] *Id.* § 2(b), at A2.

[46] *Id.*

[47] Armour & Skeel, *supra* note 5, at 1745.

[48] *See* TAKEOVER CODE R. 25.1 (requiring the offeree board to publish and send out a circular, within fourteen days of an offer, to the company's shareholders); *id.* at R. 30.1 (regarding publication of documents, announcements, and other information); *id.* at R. 30.2 (regarding the right to receive hard copies of documents, announcements, and other information).

[49] *See id.* at R. 25.2 (requiring that the offeree board circular set out the board's opinion on the offer, its reasoning, and the advice given by its appointed independent adviser); *see also infra* text accompanying notes 103-07.

during the deal process.[50] However, acting in "[c]ontravention of a rule-based requirement or a disclosure requirement does not give rise to any right of action for breach of statutory duty" by a director.[51] This prevents shareholders from also bringing a derivative suit and exposing directors to possible multiple liability for the same activity. This is a stark contrast to how the U.S. regulates the deal activity of directors, where derivative suits based on breach of fiduciary duties control the actions of directors.[52] Instead, a different means of enforcement has been used in the U.K.

2. Enforcement of the Takeover Code

When the Takeover Code was first drafted in 1968, the Takeover Panel did not have statutory authority to enforce the Code under the Companies Act.[53] Therefore, the Panel could not enforce the substantive provisions of the Code through fines, injunctions, or ordering the payment of compensatory damages.[54] Instead, the Panel issued formal public censures of violators and "implored the investment banks that advised parties in takeover transactions to honor its rulings by holding the banks responsible for their clients' violations."[55] This was done through a process called "cold shouldering," where the banking community and investors would refuse to deal with companies that violated the Code.[56] This threat forced directors of public companies to follow the Code's provisions because they otherwise could not obtain the services of investment bankers, which made it difficult for the company to raise capital in the future.[57] As stated by former Takeover Panel Chairman Robert Alexander:

> It is sometimes said that the Panel lacks adequate power of sanction. In fact, the decisions of the Panel are in practice complied with. Almost all of those with whom the Panel deals

---

[50] *See* TAKEOVER CODE R. 3.1; *id.* at App. 3.1; *see also infra* Parts III.B.2, IV.B, V.B.

[51] COMPANIES ACT 2006 (Ch. 46), pt. 28, ch. 1, § 956(1).

[52] *See supra* Part II.A.1.

[53] Andrew Johnston, *Takeover Regulation: Historical and Theoretical Perspectives on the City Code*, 66 CAMBRIDGE L.J. 422, 444 (2007); Brian E. Rosenzweig, Note, *Private Versus Public Regulation: A Comparative Analysis of British and American Takeover Controls*, 18 DUKE J. COMP. & INT'L L. 213, 215 (2007)..

[54] Johnston, *supra* note 53, at 444.

[55] Rosenzweig, *supra* note 53, at 215.

[56] *Id.* at 218-19.

[57] Johnston, *supra* note 53, at 444.

> are concerned to comply, and to be seen to comply, with the Code. This reflects in very great part the grave damage to the reputation of individuals, advisers and companies which would result from a breach of the Code or a failure to accept our decisions.[58]

From its original drafting and until 2004, the Panel enforced the Takeover Code in this fashion. However, in 2004 the European Parliament enacted what has become known as the "Takeover Directive."[59] This European Union directive "require[d] the Member States to designate competent authorities for the supervision of bids and to equip them 'with all the powers necessary for the purpose of carrying out their duties, including that of ensuring that the parties to a bid comply with the rules made.'"[60] As a result of the implementation of the Takeover Directive, the U.K. enacted Section 943 of the Companies Act, which statutorily adopted the rules of the Takeover Code currently in effect.[61] Section 943 also gives the Takeover Panel the authority to enact future rules regulating: "(i) takeover bids, (ii) merger transactions, and (iii) transactions . . . that have or may have, directly or indirectly, an effect on the ownership or control of companies."[62] The Companies Act also grants the Takeover Panel authority to "give rulings on the interpretation, application or effect of rules," which has binding effect.[63] The Takeover Panel may impose compensatory damages resulting from the violation of a rule,[64] or obtain a court order to enjoin a person who has, or will, violate a rule-based requirement.[65] Although the investment community can continue to use the self-regulating methods of enforcement through "cold shouldering," the Takeover Panel now has statutory authority to enact, interpret, and enforce its own rules pursuant to the Companies Act.

---

[58] PANEL ON TAKEOVERS & MERGERS, REPORT ON THE YEAR ENDED 31ST MARCH, 1987, at 5-6, http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/report1987.pdf (1987).

[59] *See generally* Directive 2004/25, of the European Parliament and of the Council of 31 April 2004 on Takeover Bids, 2004 O.J. (L 142).

[60] Johnston, *supra* note 53, at 447 (quoting Council Directive 2004/25, art. 4, 2004 O.J. (L 142) 17 (EU)).

[61] *See* COMPANIES ACT 2006 (Ch. 46), pt. 28, ch. 1, § 943(3).

[62] *Id.* § 943(2)(a).

[63] *Id.* § 945.

[64] *See id.* § 954(1) ("Rules may confer power on the Panel to order a person to pay such compensation as it thinks just and reasonable if he is in breach of a rule the effect of which is to require the payment of money.").

[65] *See* COMPANIES ACT 2006 (Ch. 46), pt. 28, ch. 1, § 955(1).

The Executive of the Takeover Panel conducts the day-to-day interpretation and enforcement of the Code.[66] The Executive is not an individual, but rather a group staffed by employees "from law firms, accountancy firms, corporate brokers, investments banks and other organisations."[67] Proponents of the British system enthusiastically point out that the U.K.'s Takeover Panel and Executive are "[s]taffed by personnel on [temporary leave] from the professional community that it regulates,"[68] and describe this staff as being composed of "experts."[69] Even after obtaining statutory authority through the Companies Act, the Panel is still seen as having a "self-regulatory structure" and that "the proximity between the regulators and the industry players means that the Panel has enhanced credibility."[70]

The British system forces dealmakers to work closely with the Executive of the Takeover Panel. In fact, the Takeover Code imposes an affirmative duty on management to seek advance guidance from the Executive by requiring that "[a]ny director who has a question concerning the propriety of any action as far as the Code is concerned should ensure that the Panel is consulted."[71] Therefore, target companies must communicate with the Executive, which provides "rulings on the interpretation, application or effect of the Code before, during and, where appropriate, after takeovers or other relevant transactions."[72] This gives the Panel "jurisdiction to control nearly all aspects of the tender offer [and merger] process."[73] Much of the communication with the Executive is very informal and most of the regulatory issues in deals are resolved with "no more than a telephone call."[74] However, if the parties disagree with the Executive, they may request a proceeding in front of the Panel's Hearings Committee,[75] which will issue its

[66]*See* TAKEOVER CODE intro., § 5, at A10-11 (Panel of Takeovers & Mergers 2011) ("The day-to-day work of takeover supervision and regulation is carried out by the Executive . . . [which includes the conducting] 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.").

[67]*Id.* at A11.

[68]Armour & Skeel, *supra* note 5, at 1729.

[69]Johnston, *supra* note 53, at 422.

[70]Rosenzweig, *supra* note 53, at 233.

[71]TAKEOVER CODE app., § 3(1), at App 3.1; *see also id.* at intro., § 6(b), at A12 ("When a person or its advisers are in any doubt whatsoever as to whether a proposed course of conduct is in accordance with the General Principles or the rules, . . . that person or its advisers must consult the Executive in advance.").

[72]*Id.* at intro., § 5, at A11.

[73]Rosenzweig, *supra* note 53, at 233.

[74]*See* Armour & Skeel, *supra* note 5, at 1747.

[75]*See* TAKEOVER CODE intro., § 6(b), at A12 ("Rulings of the Executive, including any

rulings in the form of a published "Panel Statement."[76] These rulings are subject to an internal appeals process[77] and judicial review, but the courts are extremely deferential to the Panel's interpretation of the Code.[78] Therefore, the Takeover Panel has significant power and takes an extremely hands-on approach to regulating M&A transactions.

C. *Compatibility of Regulatory Regimes with Respective Substantive Rules*

U.S. companies engaged in M&A also interact with several regulatory authorities throughout the process. For example, companies must communicate with the Federal Trade Commission and the Department of Justice to receive approval before they consummate a deal to ensure that the acquisition does not violate antitrust laws.[79] Companies also communicate with the SEC to confirm compliance with securities laws,[80] as well as the Internal Revenue Service to ensure that the deal receives the desired tax treatment.[81] Because U.S. companies already have to communicate with a number of regulatory agencies during the process of a deal, having to interact with an additional regulatory agency similar to that of the U.K.'s Takeover Panel would not be overly burdensome. In fact, some scholars advocate that Congress should create a body similar to the Takeover Panel in the U.S.[82] With the substantive rules currently in place, however, there is no need for an entity such as the Takeover Panel in the U.S.'s regulatory scheme.

In the U.K., a large portion of the Takeover Panel's role in regulating deal activity includes enforcing the disclosure requirements of the Code.[83] However, the SEC primarily performs this function in the U.S.[84] Also, the

---

grant or refusal to grant a waiver or derogation from the application of any rules, may be referred to the Hearings Committee for review . . . .").

[76] *Id.* at intro., § 7(c), at A14-15 ("Proceedings before the Hearings Committee are informal[,] [t]here are no rules of evidence . . . [and] [i]t is the usual policy of the Hearings Committee to publish its rulings by means of a Panel Statement issued as promptly as possible . . . .").

[77] *See id.* at intro., § 8(a), at A16 ("The [Takeover Appeal] Board is an independent body which hears appeals against rulings of the Hearings Committee.").

[78] *See* Rosenzweig, *supra* note 53, at 222-23.

[79] *See* 15 U.S.C. § 18a(d)(1) (2006); 16 C.F.R. §§ 801.1-801.90 (2003).

[80] *See* 15 U.S.C. §§ 77a-77aa; 78a-78u (2006).

[81] *See* I.R.C. §§ 351-368 (2006).

[82] *See* Samuel C. Thompson, Jr., *Change of Control Board: Federal Preemption of the Law Governing a Target's Directors*, 70 MISS. L.J. 35, 35-36 (2000).

[83] *See infra* Part III.B.2.

[84] *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity,*

substantive rules in the U.S. give a large amount of autonomy to directors of target companies in deciding the adequacy of an offer to purchase the company.[85] These rules, as established by the Delaware courts, provide malleable standards that allow directors to consider a number of factors surrounding the deal to determine if an offer is in the best interest of the company and its shareholders.[86] This is a stark contrast to the U.K.'s Takeover Code, which sets forth bright line rules that prohibit directors from denying shareholders the opportunity to decide on the acceptability of a deal, based on the merits of a bid.[87] In the U.S., a regulatory agency similar to the U.K.'s Takeover Panel could have the ability to enforce these bright line rules, but it would be inappropriate to vest such an agency with the authority to enforce the substantive rules currently in place in the U.S. This would essentially give regulators the ability to determine the adequacy of offers, which undermines directors' ability to make decisions that are in the best interests of the company and its shareholders. Therefore, the substantive rules enacted in the U.S. preclude an entity similar to the U.K.'s Takeover Panel from having a place in the American regulatory scheme.

Because courts generally prefer flexible standards rather than bright line rules like those found in the U.K., the Delaware common law is more malleable than the Takeover Code.[88] According to Chancellor Strine, "large, publicly traded corporations rationally choose Delaware law because its preference for flexibility rather than rigidity allows corporate boards to structure corporate transactions in a manner best tailored to the particular circumstances their corporations face."[89] The opinions of the Delaware courts are styled in a manner that provides general principles and judicial

---

and Facilitates Capital Formation, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/whatwedo.shtml (last visited Jan. 1, 2012) (noting that in order to achieve its goal of permitting all investors to have access "to certain basic facts about an investment prior to buying it, and so long as they hold it . . . , the SEC requires public companies to disclose meaningful financial and other information to the public"). While enforcing disclosure requirements is primarily performed by the SEC, the Delaware courts have also recently played a role in enforcing disclosure requirements. *See* Lloyd L. Drury, III, *Private Equity and the Heightened Fiduciary Duty of Disclosure*, 6 N.Y.U. J. L. & BUS. 33, 45-46 (2009).

[85]*See infra* Parts III.B.1.

[86]*See infra* Parts IV.A, V.A (discussing the availability of takeover defenses and deal protection devices in the U.S.).

[87]*See infra* Parts IV.B, V.B.

[88]*See* Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 814 (2002) (noting that Delaware courts have always had a "long-standing practice of preferring standards to rules").

[89]Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's* Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1263 (2001).

tests that can be applied by the courts in later cases and considered by directors when structuring or defending a particular deal. However, the U.K.'s bright line rules do not allow the same flexibility.[90] Finally, in addition to a board's ability to adapt to the changing dynamics of deals, by vesting it with the autonomy to control the sales process, the substantive rules in the U.S. ultimately add value to shareholders in the sale of the company.[91]

III. SIMILAR REQUIREMENTS: DIRECTOR APPROVAL AND THE BUSINESS JUDGMENT RULE

Despite the different approaches that the U.S. and U.K. take in regulating M&A activity, the substantive requirements for director approval and advisability are almost identical. Also, the general powers and duties of American and British directors parallel one another. With respect to target companies engaged in M&A, the following section provides a brief background of these requirements.

A. *Director Approval and Advisability Requirements*

Both jurisdictions require directors of a target company to approve merger transactions. In the United States, Section 251 of the DGCL requires that the board of directors "adopt a resolution approving an agreement of merger or consolidation and declaring its advisability,"[92] and that the shareholders of the target company approve the merger agreement by majority vote.[93] Additionally, in their recommendation to shareholders, "Delaware law requires directors . . . [to] disclose such information about the background of the transaction, the process followed by them to maximize value in the sale, and their reason for approving the transaction so as to be materially accurate and complete."[94] The company must also disclose the terms of the merger agreement in Item 1.01 of SEC Form 8-K[95] and in the proxy statement to shareholders, as required by Item 14 of SEC Schedule 14A.[96] Despite the fact that Section 251 of the DGCL gives directors

[90] *See infra* Parts IV.B, V.B.
[91] *See infra* Parts IV.C, V.C.
[92] DEL. CODE ANN. tit. 8, § 251(b) (2011).
[93] *See id.* § 251(c).
[94] Matador Capital Mgmt. Corp. v. BRC Holdings, Inc., 729 A.2d 280, 295 (Del. Ch. 1998).
[95] U.S. SEC. & EXCH. COMM'N, Current Report (Form 8-K), Item 1.01.
[96] *See* 17 C.F.R. § 240.14a-101 (2011).

approval and recommendation authority in the context of merger or consolidation transactions,[97] "traditionally the board has been given no statutory role in responding to a public tender offer" under Delaware corporate law.[98]

However, U.S. securities law does give directors some duties in the context of a hostile tender offer. For example, Rule 14e-2 of the Securities Exchange Act of 1934 is "designed to prevent fraudulent, deceptive or manipulative acts or practices" in the context of takeover bids.[99] The rule requires that within ten days of receiving a tender offer, the target company must publish or send a statement to security holders disclosing whether the company, among other things, "[r]ecommends acceptance or rejection of the bidder's tender offer."[100] Both the state law and federal securities law requirements governing directors of target companies in the U.S. are very similar to those found in the U.K.

Similar to DGCL Section 251, Section 905 of the U.K. Companies Act, for example, requires that "[a] draft of the proposed terms of the [merger] must be drawn up and adopted by the directors of the merging companies."[101] U.K. shareholders must also approve the deal "by a majority in number, representing 75% in value, of each class of members" in the target company.[102] Rule 25.2 of the Takeover Code sets forth directors' advisability requirements for both mergers and takeover bids, and requires that the board of the target company send out a circular to its shareholders stating its "opinion . . . on the offer (including any alternative offers) and the board's reasons for forming its opinion."[103] Further, the offeree board circular must disclose "the substance of the advice given to the board of the offeree company by the independent [financial] adviser appointed" by the board.[104] This is essentially the same standard as in Delaware, which

---

[97]*See* DEL. CODE ANN. tit. 8, § 251(b), (c).

[98]Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 95 (Del. Ch. 2011).

[99]17 C.F.R. § 240.14e-2(a).

[100]*Id.* § 240.14e-2(a)(1).

[101]COMPANIES ACT 2006 (Ch. 46), pt. 27, ch. 2, § 905(1). This rule is similar to the requirement imposed by Section 251 of the DGCL, which requires that "[t]he board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation and declaring its advisability," and further requiring the agreement to state, among other things, "[t]he terms and conditions of the merger or consolidation." DEL. CODE ANN. tit. 8, § 251(b).

[102]COMPANIES ACT 2006 (Ch. 46), pt. 27, ch. 2, § 907(1).

[103]TAKEOVER CODE R. 25.2(a) (Panel of Takeovers & Mergers 2011).

[104]*Id.* at R. 25.2(b).

requires disclosure of the "reason for approving the transaction."[105] Also, similar to the requirements under SEC Form 8-K, the Takeover Code requires that the target company disclose the terms of an offer and its position regarding that offer,[106] and to provide the shareholders with "sufficient information and advice to enable them to reach a properly informed decision as to the merits or demerits of an offer."[107] As discussed above, the director approval and advisability requirements are nearly identical in the U.S. and the U.K.

B. *General Duty of Care and the Business Judgment Rule*

Similar to the director approval and advisability requirements, the general powers and duties of American and British directors under Delaware corporate law and the Takeover Code parallel one another.

1. United States: *Smith v. Van Gorkom*

In conjunction with DGCL Section 141's grant of power to manage the business and affairs of the corporation,[108] Delaware corporate law imposes upon directors an array of fiduciary duties to the corporation and its shareholders.[109] In the context of M&A transactions, the directors of target companies owe a fiduciary duty of care to their shareholders in the process of selling the company.[110] In fulfilling their fiduciary duties, Delaware law generally affords directors the protection of the business judgment rule, which the Delaware Supreme Court has defined in the following manner:

> The business judgment rule 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

---

[105] Matador Capital Mgmt. Corp. v. BRC Holdings, Inc., 729 A.2d 280, 295 (Del. Ch. 1998).

[106] TAKEOVER CODE R. 8.2, 25.1(a).

[107] *Id.* at R. 23.1.

[108] *See* DEL. CODE ANN. tit. 8, § 141(a) (2011) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .").

[109] *See* Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (noting that the existence and exercise of the directors' power to manage the corporation "carries with it certain fundamental fiduciary obligations to the corporation and its shareholders").

[110] *See, e.g.*, Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 368 (Del. 1993); Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985).

> action taken was in the best interests of the company. A hallmark of the business judgment rule is that a court will not substitute its judgment for that of the board if the latter's decision can be attributed to any rational business purpose.[111]

Therefore, if a target board can find a rational business purpose behind its decision to either accept or reject an offer, Delaware courts are deferential to the board's decision and grant business judgment rule protection.[112]

In *Smith v. Van Gorkom*,[113] the Delaware Supreme Court issued its bedrock decision concerning management's process during the sale of a company, requiring that the board of directors must be adequately informed in determining the merits of an offer.[114] Thus, to receive business judgment rule protection, the board should hire independent investment bankers to value the company and assess the adequacy of the offer.[115] Under Section 141(e) of the DGCL, if these advisors are selected with reasonable care, then the directors will be fully protected in relying in good faith on their advice and reports.[116] *Van Gorkom* also requires that the board have adequate information about the terms of the merger agreement prior to signing and the opportunity to probe and ask questions regarding its substance and the accompanying valuation studies through regular board meetings during negotiations.[117] Throughout the sales process, the board and counsel should

---

[111]Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 954 (Del. 1985) (internal quotation marks and citations omitted).

[112]*See* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 42 (Del. 1994) ("Under normal circumstances, neither the courts nor the stockholders should interfere with the managerial decisions of the directors. The business judgment rule embodies the deference to which such decisions are entitled.").

[113]488 A.2d 858 (Del. 1985).

[114]*Id.* at 893 (holding that the target board breached its fiduciary duty to its shareholders "by their failure to inform themselves of all information reasonably available to them and relevant to their decision to recommend the Pritzker merger").

[115]The *Van Gorkom* court, however, did not make this requirement absolute, stating:

> We do not imply that an outside valuation study is essential to support an informed business judgment; nor do we state that fairness opinions by independent investment bankers are required as a matter of law. Often insiders familiar with the business of a going concern are in a better position than are outsiders to gather relevant information; and under appropriate circumstances, such directors may be fully protected in relying in good faith upon the valuation reports of their management.

Id. at 876

[116]*See* DEL. CODE ANN. tit. 8, § 141(e) (2011).

[117]*See Van Gorkom*, 488 A.2d at 873 (holding that directors must "act in an informed and

build a record in anticipation of litigation if the deal is challenged in the Delaware Court of Chancery.[118] Delaware law in this area focuses on the board's process in choosing whether to accept or reject a merger offer, and as long as the board is adequately informed, courts will grant business judgment rule protection.[119]

2. United Kingdom: Codified Process Rules

The United Kingdom has similar rules regarding directors' duties and processes during M&A transactions. Under Section 172 of the Companies Act, directors of a company have a duty to act in a way "most likely to promote the success of the company for the benefit of its [shareholders] as a whole."[120] The general rules of English common law treated "managerial conduct during takeover bids" in a manner "consistent with its general policy of defending managerial autonomy against the demands of shareholders."[121] This is the British version of the business judgment rule, which "is the law's recognition that the courts should not, as a general rule, interfere with the way in which the board exercises its discretion to run the business."[122] Therefore, similar to in the U.S., the business judgment rule is the baseline standard of care for directors during the sale process.

The U.K. has also codified information rules within the Takeover Code similar to those established in *Van Gorkom*. Rule 3.1 requires that the "board of the [target] company must obtain competent independent advice on any offer and the substance of such advice must be made known to its shareholders."[123] The Takeover Code also requires that "the board is provided promptly with copies of all documents and announcements"

---

deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders"); *see also* DEL. CODE ANN. tit. 8, § 251(b). The directors should not simply take all information presented to them at face value.

[118] *See Van Gorkom*, 488 A.2d at 883 n.25 (noting that the target board was cast upon an "unredeemable course" when it failed to compile "some credible contemporary evidence demonstrating that the directors knew what they were doing, and ensured that their purported action was given effect").

[119] *See id.* at 872 ("The determination of whether a business judgment is an informed one turns on whether the directors have informed themselves 'prior to making a business decision, of all material information reasonably available to them.'" (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984))).

[120] COMPANIES ACT 2006 (Ch. 46), pt. 10, ch. 2, § 172(1).

[121] Johnston, *supra* note 53, at 441 (citing Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cunninghame [1906] 2 Ch. 34, CA.).

[122] *Id.*

[123] TAKEOVER CODE R. 3.1 (Panel of Takeovers & Mergers 2011).

associated with an offer.[124] Directors must also hold regular board meetings throughout the process "in order to ensure that all directors are kept up-to-date with events and with actions taken."[125] Similar to *Van Gorkom* and its progeny, U.K. law focuses on the board's process during the sale of the company.

Even though derivative suits challenging deals are not filed as frequently in the U.K., directors still must build a record of their process. The Takeover Panel has statutory authority to make reasonable requests for board meeting minutes.[126] Because these requests are made outside of litigation, the Companies Act does provide a professional privilege similar to that of the attorney-client privilege in the U.S.[127]

In both the U.S. and the U.K., the business judgment rule is the starting point when analyzing the actions of directors during the sale of company, and courts generally give deferential treatment to directors. Also, under *Van Gorkom* in Delaware and the Takeover Code in the U.K., directors have a duty to be adequately informed and must seek the advice of independent financial advisors on the adequacy of the offer. Again, the focus is on the process of informing the board, not necessarily the merits of the decision. This is where the similarities between the substantive rules in the U.S. and U.K. end.[128] While directors in the U.S. are given a great deal of autonomy in deciding on the merits of a deal,[129] that decision rests solely in the hands of the shareholders in the U.K.[130]

---

[124]*Id.* at app., § 3(1)(a).

[125]*Id.* at app., § 3(1).

[126]*Id.* ("The Panel expects directors to co-operate with it in connection with its enquiries; this will include the provision, promptly on request, of copies of minutes of board meetings and other information in their possession . . . ."); *see also* COMPANIES ACT 2006 (Ch. 46), pt. 28, ch. 1, § 947(1), (3) (noting that the Takeover Panel may, by written notice, require a person to produce any documents or information that are specified in the notice, but only if the documents or information are reasonably required in connection with the exercise of the Panel's legitimate functions).

[127]*See* COMPANIES ACT 2006 (Ch. 46), pt. 28, ch. 1, § 947(10) ("A person is not required by this section to disclose documents or information in respect of which a claim to legal professional privilege . . . could be maintained in legal proceedings."); *see also, e.g.*, LA. CODE EVID. ANN. art. 506 (2006) (regarding Louisiana's attorney-client privilege).

[128]*See infra* Parts IV, V.

[129]*See infra* Parts IV.A, V.A; *see also* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (holding that under Section 251(b) of the DGCL, directors have a duty to "act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders").

[130]*See infra* Parts IV.B, V.B; *see also* TAKEOVER CODE intro., § 2(a), at A1 ("The Code is designed principally to ensure that shareholders in an offeree company are treated fairly and are not denied an opportunity to decide on the merits of a takeover . . . .").

IV. AVAILABILITY OF TAKEOVER DEFENSES

In the recent Court of Chancery case, *Air Products and Chemicals, Inc. v. Airgas, Inc.*,[131] former Chancellor Chandler stated, "I conclude that, as Delaware law currently stands . . . the power to defeat an inadequate hostile tender offer ultimately lies with the board of directors."[132] This follows the "cardinal precept of the [DGCL] . . . that directors, rather than shareholders, manage the business and affairs of the corporation."[133] Therefore, directors of Delaware corporations may use a variety of defensive mechanisms to thwart an inadequate takeover bid for the company prior to reaching a shareholder vote.[134] The Delaware approach is fundamentally at odds with the approach taken in the U.K., where the "board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid."[135] Therefore, in the U.K., the shareholders, and not the board, ultimately decide whether to accept or reject the bid. These two policy positions have shaped substantive takeover law in these jurisdictions.

A. *United States: Takeover Defenses Permitted*

Delaware common law has established and recently reaffirmed the ability of target company directors to use takeover defenses in M&A.[136] However, there are certain limited instances where Delaware law prohibits the use of takeover defenses.[137]

1. *Unocal*, *Moran*, and the Emergence of the Poison Pill

In *Unocal Corp. v. Mesa Petroleum Co.*[138] the Delaware Supreme Court established the standard for analyzing the fiduciary duty of care for directors when using takeover defenses in response to a hostile tender

---

[131] 16 A.3d 48 (Del. Ch. 2011).
[132] *Id.* at 55.
[133] Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (citing DEL. CODE ANN. tit. 8, § 141(a)).
[134] *See* discussion *infra* Part IV.A.1.
[135] TAKEOVER CODE, General Principle 3, at B1.
[136] *See infra* Part IV.A.1; *see also Airgas*, 16 A.3d at 55.
[137] *See infra* Part IV.A.2.
[138] 493 A.2d 946 (Del. 1985).

offer.[139] The court recognized that "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders" when using takeover defenses, it was appropriate to establish "an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."[140] *Unocal* established what has become known as an "enhanced business judgment rule" standard because the board must establish more than simply a "rational basis" for its decision.[141]

As a threshold matter, the board "has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders."[142] If the offer is in the best interests of the shareholders and the directors deploy defensive measures, then they are in breach of their duty of care.[143] Therefore, in order to establish whether the directors' use of takeover defenses is proper, the *Unocal* court created a two-prong test.[144] First, the directors must establish that the takeover bid is a threat to "corporate policy and effectiveness."[145] Directors meet this burden "by showing good faith and reasonable investigation," which is "materially enhanced . . . by the approval of a board comprised of a majority of outside independent directors."[146] Subsequent cases have established that such a threat exists if the board can show the "inadequate price of [the bidder's] offer, coupled with the fact that a majority of [the target's] stockholders would likely tender into that inadequate offer."[147] In the second prong of the analysis, the target board must establish that its takeover defense was "reasonable in relation to the threat posed."[148]

Under *Unocal*, directors can consider a number of factors in deploying takeover defenses, including "inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the

---

[139]*Id.* at 955.
[140]*Id.* at 954.
[141]*See Airgas*, 16 A.3d at 92 (applying "the *Unocal* standard of enhanced judicial scrutiny" rather than the traditional business judgment rule).
[142]*Unocal*, 493 A.2d at 954.
[143]*See id.* at 955.
[144]*See id.*; *see also Airgas*, 16 A.3d at 92.
[145]*Unocal*, 493 A.2d at 955.
[146]*Id.* (internal quotation marks and citation omitted).
[147]*Airgas*, 16 A.3d at 55.
[148]*Unocal*, 493 A.2d at 955.

quality of securities being offered in the exchange."[149] If the court finds that the board's takeover defense, based on the above factors, "is neither unlawful nor unreasonable," and that the board "has acted in good faith and with due care, its decision in the absence of an abuse of discretion will be upheld as a proper exercise of business judgment."[150]

The "poison pill" is the most popular and effective takeover defense used in America today.[151] The poison pill is adopted simply by a board resolution that causes "an acquirer [to suffer] a devastating dilution in its ownership position in the event that it passes certain acquisition thresholds without the prior approval of the target's management."[152] Additionally, many companies couple their use of the poison pill with a classified board.[153] This requires a hostile bidder to "conduct a proxy contest to elect a slate of directors committed to redeeming the pill" and must do so in "two successive proxy contests in order to obtain a majority of the board," which is extremely difficult.[154] This device effectively prevents a takeover of the company without director approval. Because these takeover defenses have been so successful in thwarting hostile takeovers, "[h]undreds of firms adopted these measures after the Delaware Supreme Court upheld their legality" in *Moran v. Household International, Inc.*[155]

Former Chancellor Chandler recently stated that the Delaware Supreme Court "made clear in *Moran* that 'coercive acquisition techniques' (i.e. the well-known two-tiered front-end-loaded hostile tender offers of the 1980s) were a legally cognizable 'threat,' and the adoption of a poison pill was a reasonable defensive measure taken in response to that threat."[156] Similar to other takeover defenses, Delaware courts apply the *Unocal* standard to the poison pill.[157] Because poison pills are often adopted in

---

[149] *Id.*

[150] *Id.* at 957.

[151] Miller, *supra* note 25, at 55-56.

[152] *Id.* The poison pill (also known as a "shareholder rights plan") is described as:

> [D]esigned to dilute a hostile bidder's stake massively if the bidder acquires more than a specified percentage of target stock—usually 10 or 15%. Poison pills achieve this effect—or more accurately, would achieve this effect if they were ever triggered—by, among other things, inviting all of the target's shareholders except the bidder to buy two shares of stock for the price of one.

Armour & Skeel, *supra* note 5, at 1734.

[153] *See* Bainbridge, *supra* note 88, at 796.

[154] *Id*.

[155] Miller, *supra* note 25, at 56 (citing Moran v. Household Int'l., Inc., 500 A.2d 1346 (Del. 1985)).

[156] Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 96 (Del. Ch. 2011).

[157] *Id.* at 127 n.506 ("*Moran* and virtually every pill case since . . . have consistently applied

advance of hostile offers, there is not a specific threat to corporate policy and effectiveness, but rather there is a perceived "threat in the market place of coercive two-tier tender offers," which is sufficient for the board to deploy this takeover defense.[158]

To satisfy the second prong of the *Unocal* analysis, the "range of reasonableness" test, the board cannot unilaterally reject all offers.[159] *Moran* established that the poison pill "is not absolute" and that the board cannot "arbitrarily reject the offer."[160] Instead, the board must have the ability to redeem the poison pill if a bidder presents an adequate offer.[161] As stated by its inventor, Martin Lipton, "the pill was neither designed nor intended to be an absolute bar."[162] When using the poison pill to respond to a takeover bid, "[a] board cannot say 'never,' but it can say 'no' in order to obtain the best deal for its shareholders."[163] The Delaware Court of Chancery recently reaffirmed this notion in *Airgas*.[164] Therefore, so long as the board's use of the poison pill is reasonable, then it is a permissible takeover defense in the United States.

---

the *Unocal* analysis to defensive measures taken in response to hostile bids.").

[158] *Moran*, 500 A.2d at 1356; *see also* Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 955 (Del. 1985) (noting that in implementing a takeover defense, the directors' "duty of care extends to protecting the corporation and its owners from perceived harm whether a threat originates from third parties or other shareholders").

[159] *See Unocal*, 493 A.2d at 955 (noting that a board's power to defend against a perceived threat is not absolute, and that "[a] corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available").

[160] *Moran*, 500 A.2d at 1354 ("The Board does not now have unfettered discretion in refusing to redeem the Rights. The Board has no more discretion in refusing to redeem the Rights than it does in enacting any defensive mechanism [under the *Unocal* standard].").

[161] *Id*. (noting that the board "will be held to the same fiduciary standards . . . as they were held to in originally approving the Rights Plan" (citing *Unocal*, 493 A.2d at 954-55, 958)).

[162] Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037, 1054 (2002).

[163] *Id.*

[164] *See* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 129 (Del. Ch. 2011). In *Airgas*, Chancellor Chandler noted:

> [T]his case does not endorse 'just say never.' What it does endorse is Delaware's long-understood respect for reasonably exercised managerial discretion, so long as boards are found to be acting in good faith and in accordance with their fiduciary duties (after rigorous judicial fact-finding and enhanced scrutiny of their defensive actions).

Id.

2. *Revlon*: When Takeover Defenses are Prohibited

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[165] the Delaware Supreme Court established that takeover defenses are not always permitted.[166] The court stated that in certain circumstances, the duty of the board changes from "the preservation of [the target] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[167] This essentially occurs when the board is faced with multiple fair and adequate offers to purchase the company.[168] Because the offers are adequate, under *Unocal*, there is no longer a threat to "corporate policy and effectiveness" caused by an inadequate offer.[169] In these situations, the "directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the *best price* for the stockholders at a sale of the company."[170] Therefore, when the *Revlon* rule applies, if the directors deploy a takeover defense like the poison pill, the business judgment rule will not apply, which typically results in a breach of the directors' fiduciary duty of care.[171]

There is a significant line of case law that determines when this *Revlon* duty attaches and prohibits the use of takeover defenses.[172] When directors are faced with only one offer to purchase the company, their choice to use takeover defenses is still analyzed under *Unocal*. Under *Airgas*, "a board cannot be forced into *Revlon* mode any time a hostile bidder makes a tender offer that is at a premium to market value."[173] In fact, in situations involving only one offeror, the *Revlon* duty does not attach until the directors

---

[165] 506 A.2d 173 (Del. 1986).

[166] *Id.* at 185.

[167] *Id.* at 182.

[168] *See id* ("[C]oncern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder").

[169] *Revlon*, 506 A.2d at 182.

[170] *Id.* (emphasis added).

[171] *See id*. at 185 (holding that the board's action of implementing a defensive measure was "not entitled to the deference accorded it by the business judgment rule," and that the board ultimately breached its duty of care when "the directors allowed considerations other than the maximization of shareholder profit to affect their judgment, and followed a course that ended the auction for Revlon").

[172] For a list of cases, see Portia Policastro, Note, *When Delaware Corporate Managers Turn Auctioneers: Triggering the* Revlon *Duty After the* Paramount *Decision*, 16 DEL. J. CORP. L. 187, 188 n.7 (1991).

[173] Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 129 (Del. Ch. 2011).

begin negotiations with that bidder.[174] Therefore, if the board is faced with only one bid, even at a premium above the market price, the board may continue to use poison pills and other takeover defenses if it is in the best interests of the company and its shareholders.[175]

The *Revlon* duty attaches when a "dissolution or break-up of the corporate entity [is] inevitable," or "when a corporation initiates an active bidding process seeking to sell itself."[176] In these cases, the board may not use takeover defenses. Instead, "obtaining the highest price for the benefit of the stockholders should . . . [be] the central theme guiding director action."[177] Because changing market conditions and the unique facts surrounding each deal, courts cannot establish a "single blueprint that a board must follow to fulfill its duties."[178] However, directors easily satisfy these duties by conducting a full-blown auction process[179] or a market canvass[180] prior to signing the merger agreement. Absent circumstances giving rise to the *Revlon* duty, directors may continue to utilize takeover defenses if their use is reasonable under *Unocal*.[181] This gives the board a significant amount of control over the sales process and the adequacy of offers.[182]

---

[174] *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242 (Del. 2009) (noting that the *Revlon* duty "to seek the best available price applies only when a company embarks on a transaction," and ruling that in this case, "[t]he time for action under *Revlon* did not begin until . . . the directors began negotiating the sale of Lyondell").

[175] *See, e.g.*, *id*. (noting that the directors of Lyondell decided to take a "wait and see" approach rather than instituting a defensive measure to fend off a possible hostile offer, and that the courts cannot tell directors exactly how to accomplish their *Revlon* duty of getting the best price for stockholders when selling the company "because [the directors] will be facing a unique combination of circumstances, many of which will be outside their control").

[176] Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1990).

[177] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

[178] Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989); *see also Lyondell*, 970 A.2d at 242 ("No court can tell directors exactly how to accomplish that goal, because they will be facing a unique combination of circumstances, many of which will be outside their control.").

[179] *See Revlon*, 506 A.2d at 182 (holding that when the break-up of the company became inevitable, the "directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company").

[180] *See Barkan*, 567 A.2d at 1287 ("When the board is considering a single offer and has no reliable grounds upon which to judge its adequacy, this concern for fairness demands a canvas of the market to determine if higher bids may be elicited.").

[181] *See supra* Part IV.A.1.

[182] *See* discussion *infra* Part IV.C.

B. *United Kingdom: Takeover Defenses Strictly Prohibited*

In contrast to Delaware common law, the U.K.'s Takeover Code strictly prohibits the use of takeover defenses.[183] The common law in force before the creation of the Takeover Code applied a fiduciary duty analysis similar to the business judgment rule in determining whether a defensive measure taken in response to a takeover bid was a legitimate management decision.[184] The English courts allowed takeover defenses with the "proper purpose" of advancing company and shareholder interests, but not those illegitimate management decisions designed to secure the directors' position on the board.[185] However, these common law rules were abrogated by the Takeover Code, which now requires that the target board "must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid."[186]

Rule 21.1 of the Takeover Code provides a bright line rule that prohibits the board from taking "*any action* which may result in *any offer or bona fide possible offer being frustrated* or in shareholders being denied the opportunity to decide on its merits."[187] Subsection (b) of this rule provides an illustrative list of specific impermissible defensive measures, which notably includes the poison pill.[188] U.K. directors must consult the Takeover Panel if there is any doubt as to whether any defensive action violates Rule 21.1.[189] Because of the fear of defensive action, the target directors must

---

[183] *See* TAKEOVER CODE R. 21.1(a) (mandating that during the course of an offer, the board must not unilaterally "take any action which may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits").

[184] Johnston, *supra* note 53, at 436.

[185] *Id.* Moreover, prior to the enactment of the Takeover Code, the courts of the U.K. have held that:

> The validity of the decision [to use a takeover defense] turns on the facts that the court finds about the board's *primary or sole purpose*. If that purpose is not to maintain control in the face of an unwelcome takeover bid, but rather is part of their normal management of the affairs of the company, their actions will not . . . constitute a breach of their fiduciary duty.

Id. at 438.

[186] TAKEOVER CODE, General Principle 3, at B1 (Panel of Takeovers & Mergers 2011).

[187] *Id.* at R. 21.1(a) (emphasis added); *see also id.* at R. 21.1 n.3 ("The declaration and payment of an interim dividend by the offeree company . . . during an offer period may in certain circumstances be contrary to General Principle 3 and this Rule in that it could effectively frustrate an offer.").

[188] *See id.* at R. 21.1(b)(ii)-(iii).

[189] *Id.* at R. 21.1 ("The Panel must be consulted in advance if there is any doubt as to whether any proposed action may fall within this Rule.").

consult the Takeover Panel even in advance of declaring special dividends[190] or redeeming shares.[191] In fact, "[a]ny director who has a question concerning the propriety of *any action* as far as the Code is concerned should ensure that the Panel is consulted."[192] Therefore, under the Takeover Code, takeover defenses are strictly prohibited in all circumstances, and directors are obligated to consult with the Panel to ensure their compliance with this mandate. These rules ultimately shift all authority away from the board and into the hands of the company's shareholders, who must evaluate the adequacy of the offer and choose whether to vote in favor of the transaction.[193]

C. *Greater Director Control Encourages Negotiation and Increases Price*

Empirical studies show that the U.K.'s prohibition of takeover defenses increases the number of successful hostile takeover bids.[194] Proponents of the British system believe that this constant threat of a successful hostile takeover has positive effects on corporate governance standards.[195] The hostile takeover is seen as an important "mechanism for rendering managers accountable to shareholders . . . [because of] the threat that if the managers fail to maximize the share price, the company may become an acquisition target."[196] Therefore, in order to secure their positions on the board in a system where takeover defenses are not permitted, directors will arguably have a heightened sense of the need to maximize shareholder value.

---

[190]*See* TAKEOVER CODE R. 21.1 n.3. The effect of the dividend is that the equity cushion in the company is decreased, which makes it a less attractive target for the offeror.

[191]*See id.* at R. 37.3 (requiring that during the course of an offer, the target company cannot redeem its shares without approval of its shareholders unless the redemption is in pursuance of a preexisting obligation, and the board receives consent from the Panel).

[192]*Id.* at app., § 3(1) (emphasis added).

[193]*See id.*, General Principle 3, at B1 ("The board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.").

[194]*See* Armour & Skeel, *supra* note 5, at 1738, Table 1 (nothing that 43% of hostile bids in the U.K. are successful compared to 24% in the U.S.).

[195]*See id.* at 1727 ("Hostile takeovers are commonly thought to play a key role in rendering managers accountable to dispersed shareholders in the 'Anglo-American' system of corporate governance.").

[196]*Id.* at 1728.

U.K. commentators also argue that the Takeover Code's absolute prohibition of takeover defenses creates more certainty than *Unocal*'s enhanced business judgment rule standard.[197] These commentators, along with institutional investors, believe that a "nebulous" common law test, which requires "a long and complex factual inquiry into [directors'] motivations" causes "delay by litigation and possible adverse publicity."[198] However, a bright line rule similar to the U.K.'s may not be appropriate in all situations that may arise in deals. As stated by the Delaware Supreme Court, "[t]he usefulness of *Unocal* as an analytical tool is precisely its flexibility in the face of a variety of fact scenarios. . . . The open-ended analysis mandated by *Unocal* is not intended to lead to a simple mathematical exercise."[199] This allows courts to adjust to the myriad of factual scenarios that can arise in the context of a deal and permit takeover defenses when they are in the best interests of the shareholders. The *Unocal* standard allows Delaware courts to strike a "balance between authority and accountability via a reasonableness standard, applied on a case-by-case basis, in which the board's motive is what weighs most heavily."[200]

Proponents of the Code also assert that the increased frequency of successful hostile takeovers in the U.K. positively impacts the value of share ownership, arguing that "when a bid is actually made, investors are able to exit from their holdings . . . at a considerable premium."[201] Commentators that take this position argue that allowing takeover defenses results in fewer takeovers, which reduces the frequency of takeover premiums.[202] Therefore, in their view, regulation similar to the Takeover Code "that prohibits defensive measures is required to ensure a constant supply of potential bidders."[203] However, a constant supply of bidders could have adverse effects on the company and the economy as a whole.

Martin Lipton, inventor of the poison pill and one of the nation's leading deal lawyers, stated that "proscribing the ability of companies to

---

[197]*See* Johnston, *supra* note 53, at 443-44.

[198]*Id.* at 444.

[199]Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990).

[200]Bainbridge, *supra* note 88, at 816 (citation omitted).

[201]Johnston, *supra* note 53, at 451.

[202]*See* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1164 (1981) (arguing that the "current legal rules allowing the target's management to engage in defensive tactics in response to a tender offer decrease shareholders' welfare . . . [because the] defensive tactics result in a defeat of a takeover, causing shareholders to lose the tender premium").

[203]Johnston, *supra* note 53, at 451.

defend against takeovers would adversely affect long-term planning and thereby jeopardize the economy."[204] Lipton argues that the omnipresent threat of a takeover "would have a fundamental impact on the way in which corporations operate."[205] This results in a lack of assurance of continuity to these corporations' constituencies, including their employees, creditors, customers, and suppliers, which "would cause major disruptions in the manner in which business is now conducted."[206] The uncertainty caused by numerous takeover bids that threaten corporate productivity is limited by allowing the use of takeover defenses, which eliminates the uncertainty of potentially disruptive takeovers.[207]

Takeover defenses like the poison pill also ensure that the board of directors will play a crucial role in the context of a takeover.[208] Many argue that takeover defenses encourage more negotiated transactions, which ultimately may have a greater benefit to shareholders by increasing the price of the bid.[209] Directors of target companies are in the best position to value the company because they have access to the most current and relevant information, and they are the most familiar with the business and its operations.[210] Because shareholders lack the information that due diligence reveals, allowing shareholders to make the ultimate decision in all

---

[204]Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 105 (1979).

[205]*Id.* at 110.

[206]*Id.*; *see also* A. Gilchrist Sparks, III & Kenneth J. Nachbar, *Corporate Deal Protection—The Lay of the Land in Delaware*, *in* CONTESTS FOR CORPORATE CONTROL CURRENT OFFENSIVE & DEFENSIVE STRATEGIES IN M&A 499, 502 (Practising Law Institute ed., 2001) (Handbook Series No. 1225) (noting that "business combinations can be extremely disruptive to a corporation" because there are "significant issues of employee retention; and there may be issues concerning suppliers, lenders and other persons who transact with the corporation").

[207]As stated by Lipton, "[r]ather than forcing directors to consider only the short-term interests of certain shareholders, national policy requires that directors also consider the long-term interests of the shareholders and the company as a business enterprise with all of its constituencies in addition to the short-term and institutional shareholders." Lipton, *supra* note 204, at 115.

[208]*See* TW Servs., Inc. v. SWT Acquisition Corp., 1989 WL 20290, at *10 (Del. Ch. 1989), *reprinted in* 14 DEL. J. CORP. L. 1169, 1190 (1989) (noting that with the development of the poison pill, "boards of directors began taking upon themselves, unilaterally in practically all instances, the power to reject a public tender offer . . . by adopting the poison pill stock rights plan").

[209]*See* Rosenzweig, *supra* note 53, at 234; *see also* Gregory Jackson & Hideaki Miyajima, *Varieties of Capitalism, Varieties of Markets: Mergers and Acquisitions in Japan, Germany, France, the UK and USA* 19 (Research Inst. of Econ., Trade & Indus., Discussion Paper Series 07-E-054, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1012210 ("[I]t has been widely argued that poison pills do not necessarily frustrate a deal entirely, but lead to further negotiations and may improve the price of a bid.").

[210]*See* Rosenzweig, *supra* note 53, at 234.

circumstances could be detrimental to their interests.[211] Instead, a better system is one that allows directors to reject inadequate offers and increase the likelihood of more favorable offers.

Poison pills give directors this ability to reject inadequate offers, which in turn increases the bargaining power of the board.[212] Allowing target boards to use takeover defenses like the poison pill forces a bidder to "negotiate with the target's board, offering terms attractive enough to convince the existing board to cancel, waive, or redeem these contingent rights."[213] Without a pill in place, a bidder can bypass the board and go directly to the shareholders with a tender offer at a lower price than directors could negotiate.[214] By requiring these negotiations, poison pills result in higher takeover premiums for shareholders.[215] Several empirical studies testing different time periods and sample sizes of deals in the U.S. have shown that poison pills increase takeover premiums between 7.8% and 21.4%.[216] Because the Takeover Code prohibits poison pills and other takeover defenses that frustrate shareholders' ability to decide on the merits

---

[211] *See* Lipton, *supra* note 162, at 1063-64.

[212] Dale Arthur Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 120-21 (1986).

[213] *Id.* at 121; *see also* Strine, *supra* note 89, at 1267 (arguing that takeover defenses provide "corporate boards the ability to protect their stockholders from structurally coercive tender offers and to negotiate better offers" (citation omitted)).

[214] *See* Bainbridge, *supra* note 88, at 808 (arguing that if a bidder can bypass the board by making a tender offer, "hard bargaining by the target board becomes counterproductive . . . [and] will simply lead to the bidder making a lowball tender offer to the shareholders, which they probably will accept due to the collective action problems that preclude meaningful shareholder resistance").

[215] Robert Comment & G. William Schwert, *Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures*, 39 J. FIN. ECON. 3, 38 (1995) ("[E]vidence that takeover premiums are higher when target firms are protected by state laws or by pills suggests that the relative bargaining positions of bidders and targets are altered by these antitakeover devices, raising the costs to the bidder and the gains to the target.").

[216] *See* Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L.J. 621, 637, Figure 2 (2003). In his essay, Subramanian recognizes that "[t]argets with pills achieve higher premiums than targets without pills." *Id*. at 637. He questions these studies, however, noting that:

> [V]irtually all targets that do not have pills have the option to put them in at any point during the takeover negotiation; thus, friendly acquisitions are generally negotiated in the "shadow" of the poison pill. Because acquirers will know this fact as well, it is unclear how to interpret the results from the pill premium studies.

Id. at 637-38 (citation omitted). For further discussion, see John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 271, 312 (2000) (recognizing that "firms that have adopted pills before a bid or other acquisition receive higher premiums than firms that have not," but questioning the correlation between pills and higher premiums).

of a bid, directors of British companies do not have the same bargaining power and ability to negotiate higher premiums. Additional empirical studies support this position by revealing that the average premium paid above market price in all U.S. deals (both hostile and negotiated) is 3.8% to 6.4% higher than in the U.K.[217] Despite the populist appeal of empowering shareholders,[218] U.S. companies demand higher premiums because the American takeover regime promotes negotiated acquisitions, which lead to higher prices.[219] Because directors have the ability to control the sales process through the use of takeover defenses, which ultimately leads to higher premiums for shareholders, Delaware's rule of allowing the reasonable use of takeover defenses is superior to the U.K. Takeover Code's absolute prohibition.

V. AVAILABILITY OF DEAL PROTECTION DEVICES

The U.S. and U.K. also take very different approaches regarding directors' ability to use "deal protection devices," which are provisions within the merger agreement designed to ensure that the deal closes.[220] Because a long delay, typically several months or more, transpires between the signing of the merger agreement and the closing, bidders desire the assurance that deal protection devices provide.[221]

---

[217] *See* G. Alexandridis, D. Petmezas & N.G. Travlos, *Gains from Mergers and Acquisitions Around the World: New Evidence*, 39 J. FIN. MGMT. 1671, 1678, Table II (showing that from 1990 to 2007, premiums in the U.S. were 3.77% higher than in the U.K.); Jackson & Miyajima, *supra* note 209, at 50, Figure 24 (showing that from 2000-2005, the average share price premium paid over the market price four weeks prior to the announcement date of all M&A transactions was 6.4% higher in the U.S. than in the U.K.).

[218] Those supporting a shareholder primary theory believe that shareholders should exercise ultimate control over the corporate enterprise. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440-441 (2001).

[219] *See* Rosenzweig, *supra* note 53, at 235.

[220] *See* Afra Afsharipour, *Transforming the Allocation of Deal Risk Through Reverse Termination Fees*, 63 VAND. L. REV. 1161, 1175 (2010) ("[D]eal protection devices are woven into the covenants, conditions, and termination sections of the agreement . . . [to shield] the deal from third-party bidders.").

[221] *See* Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Corporate Acquisitions*, 75 MINN. L. REV. 239, 240-41 (1990); *see also* Christina M. Sautter, *Rethinking Contractual Limits on Fiduciary Duties*, 38 FLA. ST. U. L. REV. 55, 63-67 (2010) (noting that "in the vast majority of public company acquisitions, there is an often rather lengthy delay between the execution of a definitive acquisition agreement and the closing of that transaction," and also discussing the factors that delay the closing of a transaction, including stockholder approval, regulatory approvals, and required third party consents).

In *Omnicare, Inc. v. NCS Healthcare, Inc.*,[222] the Delaware Supreme Court defined deal protection devices as "any measure or combination of measures that are intended to protect the consummation of a merger transaction."[223] Deal protection devices generally limit the emergence of third-party bidders after the execution of the merger agreement and prohibit the seller from soliciting third party offers after signing.[224] Buyers often seek deal protection because of the costs associated with performing their due diligence in assessing the target's value[225] and the potential embarrassment that would result from their offer being "jumped" by a third party.[226] Target companies utilize deal protection devices to reduce the risk of withdrawal of a favorable offer to purchase the company.[227] Directors may also use these provisions as leverage to negotiate a higher purchase price, which results in a greater premium for the company's shareholders.[228] Compared to Delaware jurisprudence, the U.K.'s Takeover Code significantly limits directors' ability to use deal protection devices and will prohibit their use in the near future.[229]

There are several deal protection devices that are commonly used to ensure the consummation of a merger. One of the most common and effective is the no-shop provision. No-shop provisions "prevent a target's board from actively soliciting bids after the target has entered into a definitive agreement with an initial acquirer."[230] Typically, the target also cannot provide any material non-public information to third parties.[231] No-

---

[222] 818 A.2d 914 (Del. 2003).

[223] *Id.* at 933-934.

[224] *See* Afsharipour, *supra* note 220, at 1175.

[225] *See* Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops—The Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 BROOK. L. REV. 525, 532 (2008); *see also* Heath Price Tarbert, *Merger Breakup Fees: A Critical Challenge to Anglo-American Corporate Law*, 34 LAW & POL'Y INT'L BUS. 627, 632 (2003) (stating that transaction costs including "expert analysis, due diligence reports by lawyers, and fairness opinions by investment bankers . . . can cost an acquirer millions." (internal quotation marks and citations omitted)).

[226] *See* Sautter, *supra* note 225, at 532 ("[I]f a deal is not completed, the initial acquirer may suffer a decrease in its own stock price and may be viewed as 'weak' in the market for corporate control.").

[227] *See* Tarbert, *supra* note 225, at 633.

[228] *See* discussion *infra* Part V.C.

[229] *See infra* Part V.B.

[230] Sautter, *supra* note 225, at 534 (emphasis omitted).

[231] For an example of a no-shop provision that includes restrictions on disclosing material non-public information to third parties, see Southwest Airlines Co., Agreement and Plan of Merger by and among Southwest Airlines Co., AirTran Holdings, Inc. and Guadalupe Holdings Corp. (Form 8-K) [hereinafter Southwest Airlines Agreement], at Exhibit 2.1, Art. 5, Section 5.6(a) (Sept. 26, 2010):

shop provisions are typically paired with a "fiduciary out" that allows the target's board to provide due diligence materials to and negotiate with a third party that makes an unsolicited offer to purchase the company.[232] The fiduciary out also allows the target's board to accept an unsolicited third-party offer if doing so is necessary to avoid breaching its fiduciary duties.[233] Fiduciary outs allow directors to act in the best interests of the shareholders by terminating a pre-existing merger agreement and accepting a superior unsolicited proposal should one materialize.[234]

The majority of merger agreements in the U.S. also include termination fee provisions.[235] Under certain circumstances, the target company pays termination fees to the buyer if the target company terminates the merger agreement prior to closing.[236] The amount of the termination fee

---

> AirTran shall not . . . (i) solicit, initiate, endorse, or knowingly encourage or facilitate (including by way of furnishing non-public information) any inquiry, proposal, or offer or afford access to the employees, business, properties, assets, books, or records of AirTran or any of the AirTran Subsidiaries, with respect to the making or completion of any Acquisition Proposal, (ii) engage in, continue, or otherwise participate in any discussions . . . or negotiations regarding, or furnish to any Person any non-public information or data with respect to, any Acquisition Proposal, or (iii) resolve, propose, or agree to do any of the foregoing.

Id.

[232]*See* Sautter, *supra* note 225, at 534. For an example of a fiduciary out provision, see Southwest Airlines Agreement, Art. 5, Section 5.6(b):

> Notwithstanding anything to the contrary in Section 5.6(a) [the no-shop provision], if at any time following the date of this Agreement and prior to obtaining the AirTran Stockholder Approval, AirTran receives a bona fide written Acquisition Proposal that was not solicited or initiated on or after the date of this Agreement in violation of Section 5.6(a), and if the AirTran Board . . . determines in its good faith judgment, after consulting with [financial advisors and outside legal counsel] that such Acquisition Proposal constitutes or could reasonably be expected to lead to a Superior Proposal and that there is a reasonable probability that the failure to take such action would cause the AirTran Board to violate its fiduciary duties to AirTran and its stockholders under Nevada Law, AirTran and its Representatives may (x) furnish . . . information and data (including non-public information) with respect to AirTran . . . and (y) engage in, maintain, and participate in discussions or negotiations with the Person or Persons making such Acquisition Proposal . . . .

Id. (emphasis omitted).

[233]*See* Sautter, *supra* note 225, at 534; *see also* Celia R. Taylor, *"A Delicate Interplay": Resolving the Contract and Corporate Law Tension in Mergers*, 74 TUL. L. REV. 561, 622 n.346 (1999) (stating that the fiduciary out's "general intent is to give target directors the right to terminate a merger agreement if the directors believe that a change in circumstances has occurred after director approval such that an alternative course of proceeding is required by their corporate fiduciary duties").

[234]*See* Sautter, *supra* note 221, at 73.

[235]Afsharipour, *supra* note 220, at 1179.

[236]*Id.* Generally, the target company will terminate the merger agreement prior to closing due to the following circumstances:

is usually expressed as a percentage of the purchase price in the merger agreement and averages 3.4% to 3.8% in the U.S.[237] Similar to no-shop provisions, termination fees also have a deterrent effect on potential third-party bidders because rational target companies will only accept offers in excess of the consideration under the preexisting merger agreement plus the termination fee.[238] Another customary deal protection device is a matching rights provision, which allows the bidder to match a superior proposal within a specified period of time, usually two to three business days.[239] With the knowledge in the market that these matching rights exist, third parties will be reluctant to present any offer due to a potential matching bid by the acquirer under the pre-existing merger agreement.[240]

> (1) the seller's board terminates the agreement in order to accept a competing offer; (2) the seller's board changes its recommendation in favor of the transaction and the buyer elects to terminate the merger agreement rather than proceed with the shareholder vote; or (3) the transaction fails for some other specified reason, such as being voted down by the seller's shareholders after a competing proposal has been announced and is agreed to or closed within a specified period of time (ranging from six to eighteen months).

Id.

[237] Micah S. Officer, *Termination Fees in Mergers and Acquisitions*, 69 J. FIN. ECON. 431, 441 (2003) (conducting a study in the U.S. between 1988 and 2000, and showing that "[t]arget termination fees as a percentage of total deal value (the total of the cash and securities offered to target shareholders) average 3.80%"); Jin Q. Jeon & James A. Ligon, *How Much is Reasonable? The Size of Termination Fees in Mergers and Acquisitions*, 17 J. CORP. FIN. 959 (2011) (conducting a similar study between January 2001 and December 2007, and showing an average of 3.407% for termination fees in U.S.); *see also* Sautter, *supra* note 225, at 536 (noting that termination fees generally range from 1% to 5% of the deal value).

[238] *See* Afsharipour, *supra* note 220, at 1179.

[239] *See* Eleonora Gerasimchuk, *Stretching the Limits of Deal Protection Devices: From* Omnicare *to* Wachovia, 15 FORDHAM J. CORP. & FIN. L. 685, 692 (2010). For an example of a matching rights provision, see Southwest Airlines Agreement, Art. 5, Section 5.6(c),:

> [I]n the case of any Adverse Recommendation Change that is the result of a Superior Proposal . . . no such termination of this Agreement . . . may be made until after the third Business Day following Southwest's receipt of written notice from AirTran advising Southwest that AirTran intends to terminate this Agreement . . . and specifying the relevant terms and conditions of (including the identity of the Persons making the Superior Proposal) the Superior Proposal that is the basis of the proposed action by the AirTran Board, and . . . the AirTran Board shall not make such an Adverse Recommendation Change and AirTran shall not terminate this Agreement if, prior to the expiration of such three Business Day period . . . Southwest makes a proposal to adjust the terms and conditions of this Agreement that the AirTran Board determines in good faith (after consulting with and receiving the advice of outside legal counsel and the AirTran Financial Advisor) to be at least as favorable to AirTran and its stockholders as the Superior Proposal.

Id.

[240] *See* Gerasimchuk, *supra* note 239, at 692.

Merger agreements also commonly feature several other deal protection devices. Section 251(b) of the DGCL requires that the board of directors of the target company adopt a resolution approving the merger agreement and declaring its advisability.[241] Most merger agreements contain a board recommendation provision that contractually obligates the board of directors to recommend that the transaction is in the best interests of the company and its shareholders.[242] Board recommendation provisions are usually paired with a fiduciary out provision, which is known in this context as a "recommendation out."[243] If a recommendation out is in place, a board can withdraw its resolution recommending the transaction despite its contractual obligation to favorably recommend the deal to its shareholders.[244] Some merger agreements also contain "force-the-vote" provisions, which require the board of directors to submit the agreement to its shareholders for a vote, even if the board has withdrawn its recommendation.[245] As their name suggests, all deal protection devices discourage potential competing third-party bidders, which increases the likelihood that the deal will close.

---

[241]DEL. CODE ANN. tit. 8, § 251(b) (2011); *see also supra* notes 92-98 and accompanying text.

[242]For an example of a board recommendation provision, see Southwest Airlines Agreement, Art. 5, Section 5.6(c):

> The AirTran Board shall not (i) (A) fail to make the Recommendation [that the transaction is in the best interests of AirTran and its stockholders] to the stockholders of AirTran . . ., (B) adopt, approve, recommend, endorse, or otherwise declare advisable the adoption of any Acquisition Proposal, or (C) resolve, agree, or publicly propose to take any such actions . . . .

Id.

[243]*See* Sautter, *supra* note 221, at 58, 80-87 (discussing the various forms of recommendation outs). For an example of a recommendation out, see Southwest Airlines Agreement, Art. 5, Section 5.6(c):

> Notwithstanding the foregoing, at any time prior to obtaining the AirTran Stockholder Approval, the AirTran Board may make an Adverse Recommendation Change: (i) if an event, fact, circumstance, or occurrence, or combination or series thereof, that was not known to the AirTran Board as of the date of this Agreement becomes known to the AirTran Board (an "Intervening Event") or (ii) in response to a Superior Proposal . . . if, and only if, the AirTran Board determines in good faith (after consulting with and receiving the advice of outside legal counsel) that there is a reasonable probability that the failure to do so would cause the AirTran Board to violate its fiduciary duties to AirTran and its stockholders under Nevada Law, and after such Adverse Recommendation Change AirTran may terminate this Agreement . . . .

Id. (emphasis omitted).

[244]*See* Sautter, *supra* note 221, at 58.

[245]*Id*. at 62-63.

As displayed in the following sections, the permissibility of these provisions varies greatly between the U.S. and the U.K.

A. *United States: Deal Protection Analyzed under the Unocal Standard*

In the United States, the Delaware courts have generally held that deal protection devices are permissible but are subjected to enhanced judicial scrutiny beyond the business judgment rule.[246] In *Paramount Communications, Inc. v. Time Inc.*, the Delaware Supreme Court established that the adoption of deal protection devices "alone does not trigger *Revlon* . . . , [but] such devices are properly subject to a *Unocal* analysis."[247] Delaware courts use the *Unocal* analysis because the "board's decision to protect its decision to enter a merger agreement with defensive devices against uninvited competing transactions that may emerge is analogous to a board's decision to protect against dangers to corporate policy and effectiveness when it adopts defensive measures in a hostile takeover contest."[248] When analyzing deal protection devices under *Unocal*'s first prong, the Delaware Supreme Court in *Omnicare, Inc. v. NCS Healthcare, Inc.* determined that the threat to corporate policy and effectiveness was "the possibility of losing the [current] offer and being left with no comparable alternative transaction."[249] The second *Unocal* prong requires that the deal protection device be "reasonable in relation to the threat posed."[250] For the deal protection device to be reasonable, the directors must "establish that the merger deal protection devices adopted in response to the threat were not 'coercive' or 'preclusive,' and then demonstrate that their response was within a 'range of reasonable responses' to the threat perceived."[251]

---

[246] *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1151 (Del. 1990); *see also supra* Parts III.B.1, IV.A.1 (discussing Delaware's business judgment rule, and *Unocal*'s enhanced judicial scrutiny standard, respectively).

[247] *Paramount Commc'ns*, 571 A.2d at 1151.

[248] Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 932 (Del. 2003).

[249] *Id.* at 935.

[250] Unocal Corp. v. Mesa Petrol.Co., 493 A.2d 946, 955 (Del. 1985).

[251] *Omnicare*, 818 A.2d at 935 (noting that in Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995), the Delaware Supreme Court established that "[a] response is 'coercive' if it is aimed at forcing upon stockholders a management-sponsored alternative to a hostile offer," and that "[a] response is 'preclusive' if it deprives stockholders of the right to receive all tender offers or precludes a bidder from seeking control by fundamentally restricting proxy contests or otherwise." (citing *Unitrin*, 651 A.2d at 1387)).

Delaware courts generally find that no-shop provisions are reasonable and are therefore permissible under the *Unocal* standard.[252] In *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*,[253] the Delaware Court of Chancery, in an oral ruling, set forth the requirement that in order to fall within the *Unocal* "range of reasonableness" standard, no-shop provisions must be paired with a fiduciary out that allows the board to consider a superior proposal.[254] Without the presence of a fiduciary out, a no-shop provision effectively prevents the target company from providing any non-public information to or negotiating with a third party, which could lead to a superior proposal and benefit the company's shareholders.[255] As stated by former Chancellor Chandler in *Phelps Dodge*, such action by directors "is the legal equivalent of willful blindness, a blindness that may constitute a breach of a board's duty of care."[256] Additionally, under the fiduciary out provision, a board cannot contract away its fiduciary duty of care and delegate the decision of whether the board should consider a potentially superior proposal to a third party.[257] The fiduciary out can, and often does, require that the board consult financial advisors and outside legal counsel.[258] However, as stated by the Court of Chancery in *Ace Ltd. v. Capital Re Corp.*,[259] the board of directors of a target company has a "duty to determine what its own fiduciary obligations require at precisely that time in the life of the company when the board's own judgment is most important," which includes the sale of company.[260] Therefore, no-shop provisions are permissible in the U.S. if they are paired with a fiduciary out that leaves all decision-making authority with the board of directors.

Delaware courts also treat termination fees favorably and analyze their reasonableness in terms of the percentage of the merger consideration.[261] In *Phelps Dodge*, Chancellor Chandler stated, in *dicta*, that a 6.3% termination fee "seems to stretch the definition of range of reasonableness and probably

---

[252] 2 MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS AND FREEZEOUTS § 5A.03, 5A-42 (Law Journal Press ed., 1978).

[253] 1999 WL 1054255 (Del. Ch. Sept. 27, 1999).

[254] *See id.* at *2.

[255] *See id*.

[256] *Id.*

[257] *See* Sautter, *supra* note 221, at 76-77 (citing Ace Ltd. v. Capital Re Corp., 747 A.2d 95, 106 (Del. Ch. 1999).

[258] *See, e.g.*, Southwest Airlines Agreement, Art. 5, Section 5.6(b).

[259] 747 A.2d 95 (Del. Ch. 1999).

[260] *Id.* at 106.

[261] 2 LIPTON & STEINBERGER, *supra* note 252, § 5A.03, at 5A-42.

stretches the definition beyond its breaking point."[262] Therefore, U.S. companies generally use lower termination fees, which average 3.4% to 3.8% of the merger consideration.[263]

Similar to termination fees, Delaware courts treat matching rights favorably.[264] In *In re Toys "R" Us, Inc. S'holder Litig.*, the Court of Chancery stated that "neither a termination fee nor a matching right is per se invalid. Each is a common contractual feature that, when assented to by a board fulfilling its fundamental duties of loyalty and care for the proper purpose of securing a high value bid for the stockholders, has legal legitimacy."[265] Therefore, matching rights are valid deal protection devices in U.S. merger agreements. Board recommendation provisions, which contractually obligate directors to recommend the deal to its shareholders, are also generally permissible.[266] However, Delaware courts have not examined how narrowly an accompanying recommendation out provision may be drafted while still meeting the reasonableness standard.[267] Delaware law also authorizes directors to use force-the-vote provisions. Under Section 146 of the DGCL, the board may send a merger "to a vote of its stockholders whether or not the board of directors determines at any time subsequent to approving [the merger] that [the merger] is no longer advisable and recommends that the stockholders reject or vote against the matter."[268] As discussed in this section, Delaware corporate law makes a variety of deal protection devices available to directors of target companies.

When examining a merger agreement, Delaware courts do not determine the reasonableness of each isolated deal protection device; instead, they examine deal protection devices in the aggregate and in light of their interaction with one another.[269] The Delaware courts' use of the *Unocal*

---

[262]Phelps Dodge Corp. v. Cyprus Amax Minerals Co., 1999 WL 1054255, at *2 (Del. Ch. Sept. 27, 1999).

[263]*See supra* note 237 and accompanying text.

[264]*See In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1017 (Del. Ch. 2005).

[265]*Id*; *see also In re* Smurfit-Stone Container Corp. S'holder Litig., 2011 WL 2028076, at *21 & n.141 (Del. Ch. May 20, 2011) (discussing the reasonable and customary use of matching rights); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 615 (Del. Ch. 2010) (holding that the board's use of various deal protection devices, including matching rights, was reasonable).

[266]*See supra* note 242 and accompanying text.

[267]*See* Sautter, *supra* note 221, at 60 ("To date, the Delaware courts have never directly addressed the validity of provisions limiting merger recommendation fiduciary outs to Superior Offers and/or Intervening Events.").

[268]DEL. CODE ANN. tit. 8, § 146 (2011).

[269]*See, e.g.*, *In re* Cogent, Inc. S'holder Litig., 7 A.3d 487, 508-09 (Del. Ch. 2010) (examining the deal protection devices in the aggregate and deeming them reasonable).

standard gives directors the ability to choose whether deal protection devices will benefit the corporation and its shareholders. This flexible approach allows directors to tailor the merger agreement to fit the specific needs of the deal.[270]

B. *United Kingdom: Recent Amendments Prohibit Deal Protection Devices*

The U.K.'s Takeover Panel is not nearly as receptive of deal protection devices as the Delaware courts. On July 21, 2011, the Takeover Panel's Code Committee revised the Takeover Code to generally prohibit the use of all deal protection devices.[271] These amendments, which took effect on September 19, 2011, will amplify the differences between British and American deal activity.[272] Because deal protection devices generally have a deterrent effect on third-party offers, the Panel's aversion to them is consistent with the general policy that shareholders should not be "denied an opportunity to decide on the merits" of a transaction.[273] Prior to the July, 2011 revision, Rule 21.2 of the Takeover Code permitted the use of *de minimis* termination fees.[274] The Code provided that if a termination fee exceeded 1% of the purchase price in the merger agreement, it is no longer *de minimis*.[275] The Code set this 1% limit because the Panel took the position that termination fees should only compensate for due diligence and transaction costs, and not "prevent the possible payment of an inducement fee from frustrating a competing bid."[276] Despite the restrictions on

---

[270] *See* Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919, 923 (2001) (advocating the "inescapable need for the law to deal with the complexities of deal protection measures in a more supple way").

[271] *See* THE TAKEOVER PANEL CODE COMMITTEE, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS, PUBLICATION OF RS 2011/1 (Panel Statement 2011/18, July 21, 2011).

[272] *See id.* at 1.

[273] TAKEOVER CODE intro., § 2(a), at A1 (Panel of Takeovers & Mergers 2011).

[274] *See* THE TAKEOVER PANEL, CONSULTATION PAPER ISSUED BY THE CODE COMMITTEE OF THE PANEL, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS, PROPOSED AMENDMENTS TO THE TAKEOVER CODE § 3.6(b) (PCP 2011/1, Mar. 21, 2011) (noting that the newly proposed rules were intended to prohibit "any inducement fee arrangement, including any arrangement which has a similar financial or economic effect to an inducement fee, even if any such arrangement does not actually involve any cash payment and no matter how it is structured"); TAKEOVER CODE R. 21.2 n.1(a). The Takeover Code uses the term "inducement fees" instead of termination fees.

[275] TAKEOVER CODE R. 21.2.

[276] THE TAKEOVER PANEL, PRACTICE STATEMENT NO. 23, RULE 21.2 – INDUCEMENT FEE

termination fees, the Takeover Code formerly permitted the use of other deal protection devices.[277]

However, the Panel's Code Committee recently drafted provisions that prohibit "deal protection measures and [termination] fees other than in certain limited cases."[278] These revisions prohibit directors of target companies from entering into agreements "to refrain from taking any action which might facilitate a competing transaction."[279] To achieve this result, the amendments to Rule 21.2 of the Code generally bar target companies from entering into an "offer-related arrangement" with a potential acquirer,[280] which is intended to encompass all deal protection devices as defined by the Code Committee.[281] The Committee's definition of deal protection devices includes "provisions intended to restrict the board of the offeree company from soliciting competing offers (sometimes referred to as 'no shop' provisions)."[282] Therefore, the revised Takeover Code prohibits no-shop provisions. The revision also prohibits board recommendation provisions that restrict the target company's board from changing its recommendation regarding the transaction for a fixed period of time.[283] Additionally, the Code Committee has barred force-the-vote provisions[284] and matching rights[285] in the revised version of the Takeover Code.

AGREEMENTS AND OTHER AGREEMENTS BETWEEN AN OFFEROR AND THE OFFEREE COMPANY § 1.1 (Panel Statement 2008/31, July 10, 2008).

[277] *See* THE TAKEOVER PANEL, CONSULTATION PAPER ISSUED BY THE CODE COMMITTEE OF THE PANEL, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS § 9.18, at 86 (PCP 2010/2, June 1, 2010) [hereinafter PCP 2010/2] (noting that "[T]he Code does not specifically restrict or prohibit such deal protection measures other than in relation to inducement fees").

[278] THE TAKEOVER PANEL, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS, RESPONSE STATEMENT BY THE CODE COMMITTEE OF THE PANEL FOLLOWING THE CONSULTATION ON PCP 2011/1 § 1.3(b)(i) (March 21, 2011).

[279] THE TAKEOVER PANEL, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS § 5.16(i) (Panel Statement 2010/22, Oct. 21, 2010) [hereinafter Panel Statement 2010/22].

[280] THE TAKEOVER PANEL CODE COMMITTEE, INSTRUMENT 2011/2, AMENDMENTS FOLLOWING THE CODE COMMITTEE'S REVIEW OF THE REGULATION OF TAKEOVER BIDS R.21.2(a), at 32 (July 21, 2011).

[281] *See* THE TAKEOVER PANEL, CONSULTATION PAPER ISSUED BY THE CODE COMMITTEE OF THE PANEL, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS, PROPOSED AMENDMENTS TO THE TAKEOVER CODE § 3.6(a) (PCP 2011/1, Mar. 21, 2011) (stating that the proposed general prohibition of deal protection measures is intended to prohibit "any deal protection measure of the kind identified in PCP 2010/2").

[282] PCP 2010/2, *supra* note 277, § 9.19(c), at 87.

[283] *See id.* § 9.19(e), at 88.

[284] *See id.* § 9.19(h), at 90.

[285] *See id.* § 9.19(f), at 89.

The amendment to Rule 21.2 also expressly prohibits "any [termination] fee arrangement or other arrangement having a similar or comparable financial or economic effect."[286] In the eyes of the Committee, termination fees and the aforementioned deal protection devices "deter competing offerors from making an offer, thereby denying offeree company shareholders the possibility of deciding on the merits of a competing offer."[287] Therefore, the Panel, through the Code Committee, has revised the Takeover Code and prohibited the use of all deal protection devices, including termination fees.

C. *Deal Protection Devices Increase Shareholder Premiums*

The impact of deal protection devices cannot be analyzed in a vacuum and without consideration of other factors influencing a deal, including takeover defenses. In the U.K., the decision by the Takeover Panel's Code Committee to prohibit deal protection devices is consistent with the Takeover Code's prohibition of takeover defenses and its general policy as a whole. In the Committee's view, deal protection devices leave "little, if any, room for the board of an offeree company to facilitate or recommend a competing offer, thereby frustrating bids by potential competing offerors."[288] Because of their deterrent effect, deal protection devices are "contrary to the spirit of Rule 21 and General Principle 3,"[289] which requires that "[t]he board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid."[290] According to the Code Committee, deal protection provisions "are often presented to offeree company boards by offerors and their advisers as standard 'packages' which the offeree company board is under considerable pressure to accept, with little, if any, room for negotiation."[291] The Committee further suggests that these deal protection devices restrict "the ability of the offeree company board to engage with potential competing offerors in a way that is detrimental to the interests of

---

[286] *See* THE TAKEOVER PANEL CODE COMMITTEE, INSTRUMENT 2011/2, AMENDMENTS FOLLOWING THE CODE COMMITTEE'S REVIEW OF THE REGULATION OF TAKEOVER BIDS R.21.2(b), at 32 (July 21, 2011).

[287] Panel Statement 2010/22, *supra* note 279, § 5.14(i), at 14.

[288] PCP 2010/2, *supra* note 277, § 9.1, at 80.

[289] *Id.*

[290] TAKEOVER CODE, General Principle 3, at B1 (Panel of Takeovers & Mergers 2011).

[291] Panel Statement 2010/22, *supra* note 279, § 5.13, at 14.

offeree company shareholders."[292] However, the detrimental effects of deal protection devices in the U.K. could be a product of the system in which they operate.

Devoid of the ability to use takeover defenses, directors of U.K. target companies are left in a position with little bargaining power. Because the board cannot take action that may lead to an offer being "frustrated or in shareholders being denied the opportunity to decide on its merits,"[293] directors of target companies have no power to negotiate deal protection devices on favorable terms. When the target board is forced, under the Takeover Code, to send the offer through to a shareholder vote, it has no negotiating leverage. Leaving directors of target companies powerless in this situation can adversely affect the company. If a target company, for example, received several offers that are all deemed insufficient through shareholder vote, the target company would be forced to make repeated payments of a termination fee to the bidder. The poison pill and other takeover defenses prevent this scenario in the U.S., but such a scenario may come to fruition in the U.K. because of the prohibition of takeover defenses. The Code Committee recognized this and decided to generally prohibit the use of deal protection devices in the U.K. Even though this may be the appropriate course of action in the U.K., the ability to use deal protection devices in conjunction with takeover defenses in the U.S. is in the best interests of the corporation and its shareholders.

By empowering U.S. directors with the ability to reasonably use takeover defenses and deal protection devices, Delaware law provides directors with the flexibility needed to act in the best interests of shareholders and adjust to the dynamics surrounding the deal. As stated by the Court of Chancery in *In re Toys "R" Us, Inc.*:

> [The] reasonableness inquiry does not presume that all business circumstances are identical or that there is any naturally occurring rate of deal protection, the deficit or excess of which will be less than economically optimal. Instead, that inquiry examines whether the board granting the deal protections had a reasonable basis to accede to the other side's demand for them in negotiations. In that inquiry, the court must attempt, as far as possible, to view the question from the perspective of the

[292] *Id.* § 3.1(vi), at 5.
[293] TAKEOVER CODE R. 21.1(a).

> directors themselves, taking into account the real world risks and prospects confronting them when they agreed to the deal protections. As *QVC* clearly states, what matters is whether the board acted reasonably based on the circumstances then facing it.[294]

Using this realistic approach, instead of bright line rules, the reasonableness standard of the Delaware courts allows directors of target companies to act appropriately and use deal protection devices to the shareholders' advantage, while still holding directors accountable for unreasonable use of deal protection contrary to their fiduciary duties.

Similar to Lipton's argument advocating the use of takeover defenses, deal protection devices can also eliminate the disruptive effects to corporations[295] and the economy in general caused by the uncertainty resulting from M&A activity.[296] Commentators argue that deal "jumping" multiplies these disruptive effects, and therefore, "it is in the corporation's interest to have as much certainty in a business combination as possible; announcement of successive transactions (combination with Company A, followed by announcement that the combination will in fact be with Company B, etc.) can wreak havoc."[297] Therefore, deal protection devices that eliminate this uncertainty are desirable.

Termination fees and other deal protection devices, in many situations, may also induce additional bids to acquire the company.[298] The

---

[294] *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1016 (Del. Ch. 2005) (citation omitted).

[295] *See* Lipton, *supra* note 204, at 110 ("The scramble by [a corporation's] constituencies to protect against [a] sale or liquidation would cause major disruptions in the manner in which business is now conducted.").

[296] *See id.* at 105 (noting that "proscribing the ability of companies to defend against takeovers would adversely affect long-term planning and thereby jeopardize the economy").

[297] Sparks & Nachbar, *supra* note 206, at 502.

[298] *See* Tarbert, *supra* note 225, at 664 (noting that many economists and M&A lawyers believe that breakup fees are "catalysts for competitive bidding, rather than annihilators," and that they may be necessary to attract serious bidders); *see also* Sean J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of* Omnicare v. NCS Healthcare, 29 J. CORP. L. 569, 613 (2004) (arguing that deal protection may be "necessary to bring a would-be acquiror to the bargaining table . . . [and that] [w]ithout the ability to do so, targets may not be able to entice would-be acquirors to begin negotiations, leaving targets with a lesser (and potentially worse) set of options"); Officer, *supra* note 237, at 456; Audra L. Boone & J. Harold Mulherin, *Do Termination Provisions Truncate the Takeover Bidding Process?*, 20 REV. FIN. STUD. 461, 465 (2007) ("By providing compensation in the event that the target is acquired by another bidder, termination provisions are a contractual means to induce participation in the takeover process.").

announcement of a merger agreement that includes deal protection devices could signal to the market that a company is an attractive target and could stimulate an auction with multiple new bidders.[299] In an auction situation, deal protection devices also encourage bidders to make their best offers.[300] Because these provisions "make it difficult for a competing bidder to make a subsequent topping bid, each bidder will have an incentive to make its best bid."[301] Therefore, in many instances, deal protection devices induce serious bids instead of foreclosing them.

Deal protection devices also arm target boards with a bargaining chip that enables them to negotiate a higher price in the deal, which enhances value for the shareholders.[302] Stated in the negative, the absence of deal protections within a merger agreement could cause a bidder to offer a discounted price to account for the risk of non-consummation of the deal.[303] Several empirical studies have examined the effect of termination fees on negotiated acquisitions and have found that deals including termination fees have significantly higher completion rates and larger deal premiums than those deal that do not.[304] These studies show that the presence of target termination fee provisions increase the probability of deal completion by 15% to 20%.[305] By providing for a termination fee within the merger

---

[299] *See* Tarbert, *supra* note 225, at 664 (noting that deal protection devices stimulate multiple offers by making the market aware of the target's reserve price, and by reducing the time and effort that new bidders must spend in valuing the target company).

[300] *See* Sparks & Nachbar, *supra* note 206, at 503.

[301] *Id.*; *see also* Paul Povel & Rajdeep Singh, *Takeover Contests with Asymmetric Bidders*, 19 REV. FIN. STUD. 1399, 1425 (2006) (noting that "the possibility of an exclusive deal encourages the better-informed bidder to reveal a high willingness to [a high] pay," and therefore, "shareholder value maximizing target boards should in practice make frequent use of deal protection devices").

[302] *See* Stephen M. Bainbridge, *Precommitment Strategies in Corporate Law: The Case of Dead Hand and No Hand Pills*, 29 J. CORP. L. 1, 24 (2003) (asserting that deal protection devices give the target's board a useful negotiating tool because "[i]n return for reducing the risk of nonconsummation, they can be used to extract a higher price from the bidder"); *see also* Bainbridge, *supra* note 221, at 285; Griffith, *supra* note 298, at 613; Thomas W. Bates & Michael L. Lemmon, *Breaking Up is Hard to Do? An Analysis of Termination Fee Provisions and Merger Outcomes*, 69 J. FIN. ECON. 469, 472 (2003) (arguing that deal protection devices "improve the contracting environment and thus enhance the value of targets in negotiated corporate takeovers").

[303] *See* Bainbridge, *supra* note 221, at 285 ("[B]ecause rational bidders presumably discount their bids to account for the risk that the target board will renege, decreasing this risk through the use of [deal protection devices] should automatically offset any such tendency."); *see also* Griffith, *supra* note 298, at 614.

[304] *See generally* Bates & Lemmon, *supra* note 302; Officer, *supra* note 237.

[305] *See* Bates & Lemmon, *supra* note 302, at 484 ("[T]he presence of target termination fee provision increases the probability of deal completion by approximately 15.5%."); Officer, *supra* note 237, at 433 ("[T]arget termination fees increase the likelihood that the deal is successfully

agreement, the target board gives the acquirer a greater assurance that the deal will close, and therefore is in a better bargaining position when it comes to price. These same studies also show that bid premiums are 4% to 6% higher in deals that include target termination fees compared to deals that do not.[306] This data supports the argument that termination fees improve the bargaining power of target directors, which leads to increased premiums for shareholders.[307]

In 2002, the enactment of the Sarbanes-Oxley Act initiated an exodus of publicly traded U.S. companies to foreign exchanges, including those in the U.K., in order to avoid these new burdensome and costly regulations.[308] Because the British regime now completely strips directors of any negotiating power during the deal process, this most recent revision to the Takeover Code could have the reverse effect, which would drive companies away from the U.K. and back to the U.S. Because of the improved bargaining position resulting from the use of deal protection devices coupled with takeover defenses, directors of U.S. companies, under Delaware law, have the ability to negotiate higher premiums for their shareholders. By empowering directors of target companies with these devices, the substantive rules in the U.S. generate greater value and premiums for shareholders than those found in the U.K.

VI. CONCLUSION

The availability of takeover defenses and deal protection devices gives directors of U.S. target companies the ability to adapt to the unique circumstances surrounding each deal and generate higher premiums for shareholders in M&A transactions compared to their colleagues in the U.K.

---

completed by almost 20% on average.").

[306]*See* Bates & Lemmon, *supra* note 302, at 494 ("[B]id premiums are between 3.7% and 6.3% higher in deals that include target termination fees compared to deals that do not."); Officer, *supra* note 237, at 433 ("[T]arget termination fee use is associated with approximately 4% higher takeover premiums after controlling for correlated deal characteristics.").

[307]*See* Bates & Lemmon, *supra* note 302, at 502 (noting that "target fees improve the bargaining position of target managers"); Officer, *supra* note 237, at 435 ("[T]arget managers appear to be able to improve their bargaining position and extract higher premiums from bidders through the use of a target termination fee.").

[308]*See e.g.*, RAFFAELE SCALCIONE, THE DERIVATIVES REVOLUTION: A TRAPPED INNOVATION AND A BLUEPRINT FOR REGULATORY REFORM 272 (2011); Silvia Ascarelli, *Citing Sarbanes, Foreign Companies Flee U.S. Exchanges*, WALL ST. J., Sept. 20, 2004, at C1; Jonas V. Anderson, Note, *Regulating Corporations the American Way: Why Exhaustive Rules and Just Deserts are the Mainstay of U.S. Corporate Governance*, 57 DUKE L.J. 1081, 1082-83 (discussing the exodus of publicly-traded companies from U.S. exchanges to foreign exchanges, including the U.K.).

Because Delaware corporate law empowers them with these tools, directors of U.S. target companies have more negotiating power and control over the sale of the company, which ultimately leads to increased premiums for shareholders. The use of a malleable reasonableness standard allows directors to act appropriately depending on the facts and circumstances surrounding a deal, while also allowing courts to hold directors accountable under a fiduciary duty analysis. The substantive rules developed through the Delaware common law and the DGCL place the ultimate power and authority in the hands of the board of directors during the sale of the company.

This is in stark contrast to the U.K. Takeover Code's bright line rules that strip the board of any ability to use takeover defenses and now prohibits the use of deal protection devices. Instead, the authority to decide on the merits of a transaction rests solely with the shareholders of the company. By eliminating these devices, the revised Takeover Code significantly reduces the board's negotiating power. Empirical studies have shown that the availability of takeover defenses and deal protection devices ultimately allow directors to negotiate higher priced deals. Therefore, the U.S. has the superior regime, which allows directors to divert the flow of offers into a negotiated acquisition process and generate additional value for the company's shareholders.