IS MODERATION THE HIGHEST VIRTUE? A COMPARATIVE STUDY OF A MIDDLE WAY OF CONTROL TRANSACTION REGIMES

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ABSTRACT

Comparative studies of control transaction regimes mostly compare the Market Rule as adopted in the United States and the General Offer Rule as adopted in the European Union. In contrast, they pay less attention to the Partial Offer Rule, a middle way model adopted in many East Asian countries such as Japan, South Korea, China, Taiwan, and others. In this Article, we attempt to fill this gap by highlighting the Partial Offer Rule, analyzing its theoretical foundation and observing its implementation in practice. Our theoretical analyses of the Partial Offer Rule are comprised of two parts. First, by factoring in the cost of funds to the current economic analytical framework, we demonstrate that, from the perspective of efficiency, the Partial Offer Rule dominates the General Offer Rule and is thus more representative of the mandatory bid camp. Second, by comparing these three regimes through the lens of their respective filter mechanism, we argue that the Partial Offer Rule has its theoretical advantages. Specifically, its filter mechanism can incentivize the incumbent controlling shareholder of the target company to select an efficient acquirer, which, compared with the ones built in the Market Rule and the General Offer Rule, is more effective. In addition to theories, we also observe the implementation of the Partial Offer Rule. We identify several aspects in practice that may compromise the theoretical advantages of the Partial Offer Rule, including various types of circumvention implemented by related market

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players and the defectively-designed events of exemption adopted by rule-makers. In sum, we provide comprehensive accounts both in theory and in practice of the Partial Offer Rule, a long neglected control transaction regime.

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Confucius sighed, "Moderation should be the highest virtue!! But people have failed to embrace it for so long!!" ~~ Moderation, Chapter 3

I. INTRODUCTION

One teaching underlying Chinese traditions is the pursuit of "moderation," that is, the exploration of a "middle way" of life style in order to achieve a balance in every aspect. In this Article, we explore one "middle way" that is relatively less-noticed in comparative studies of corporate laws.

Corporate law around the world is indeed converging, but "the end of the history" of comparative corporate law has not yet arrived.[1] One areas of diverging points of view is the approach to "control transaction" regimes. There are different schools of thought on whether and how to regulate a transaction between an acquirer and the target's shareholders under which the acquirer aims to purchase the target's shares to a controlling level. To date, mainstream comparative studies of the control transaction regimes mostly concentrate on the comparison between the "Market Rule" and the "General Offer Rule."[2] On the one end, the

[1]For literatures raising the convergence observation in corporate laws, *see generally* Henry Hansmann & Reinier Kraakman, *Reflections on The End of History for Corporate Law*, *in* CONVERGENCE OF CORPORATE GOVERNANCE: PROMISE AND PROSPECTS 32 (Abdul Rasheed & Toru Yoshikawa eds., 2012); Henry Hansmann & Reineir Kraakman, *The End of History for Corporate Law*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 33 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

[2]For earlier discussion, *see, e.g.*, Noyes Leech, *Transactions in Corporate Control*, 104:6 U. PENN L. REV. 725 (1956); William D. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78:3 HARV. L. REV. 505 (1965); George B. Javaras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews*, 32 U. CHICAGO

Market Rule—a relatively hands-off model that largely defers to the autonomy of the market of control and imposes minimal legal intervention—is popular in the United States. Under this Rule, the acquirer is subject to very modest legal constraints other than disclosure. Specifically, when acquiring the target's shares, the acquirer is under no obligation to initiate a tender offer to the target's public shareholders. The decisions to acquire all or part of the target's shares as well as from which shareholder it purchases the shares are at the acquirer's discretion. This rule rests essentially on its minimum restraints of control transactions. On the other end, the General Offer Rule, an intensively-regulated model which is also referred to as the "mandatory bid rule,"[3] is widely implemented in EU countries, among others.[4] Under this Rule, if the amount of an acquirer's purchase of the target's shares reaches a controlling threshold (which is 30% of the target's issued shares in many countries), *after* such purchase the acquirer is obliged to extend a tender offer to *all* shareholders of the target, offering to purchase *all* their shares. Therefore, in the end the acquirer may be legally forced to purchase all the target's shares notwithstanding its initial partial purchase plan. This rule rests on affording greater protection to the target's

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L. REV. 420 (1965); Stanford J. Grossman & Oliver D. Hart, *Takeover Bids, The Free-Rider Problem, and the Theory of the Corporation*, 11:1 BELL. J. ECON. 42 (1980); Frank H. Easterbrook & Daniel R. Fichel, *Corporate Control Transaction*, 91:4 YALE L.J. 698 (1982); Robert W. Hamilton, *Private Sale of Control Transactions: Where We Stand Today*, 36 CASE WESTERN RES. L. REV. 248 (1986); Saul Levmore, *A Primer on the Sale of Control*, 65 TEXAS L. REV. 1061 (1987); Michael J. Barclay & Clifford G. Holderness, *The Law and Large-Block Trades*, 35:2 J. L. & ECON. 265 (1992); Einer Elhauge, *Toward a European Sale of Control Doctrine*, 41 AM. J. COMP. L. 627 (1993); Marcel Kahan, *Sales of Corporate Control*, 9:2 J. L. ECON. & ORG. 368 (1993); Lucian Arye Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109:4 Q. J. ECON. 957 (1994); John C. Coffee, Jr., *Transfers of Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions while Chilling Inefficient Ones?*, 21:2 DEL. J. CORP. L. 359 (1996); Clas Bergstrom et al., *The Optimality of the Mandatory Bid Rule*, 13:2 J. LAW, ECON. & ORG. 433 (1997); Jesper Lau Hansen, *When Less Would be More: The EU Takeover Directive in Its Latest Apparition*, 9 COLUM. J. EUR. L. 275 (2003). For recent discussions, *see, e.g.*, Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep's Clothing: Taking U.K. Rules to Continental Europe*, 11:1 U. PENN J. BUS. LAW 135 (2008); Paul Davies & Klaus Hopt, *Control Transactions, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 225 (Reineir Kraakman et al., eds., 2nd ed., 2009); William Magnuson, *Takeover Regulation in the United States and Europe: An Institutional Approach*, 21: PACE INT'L L. REV. 205 (2009); Seimone M. Sepe, *Private Sale of Corporate Control: Why the European Mandatory Bid Rule is Inefficient* (Arizona Legal Studies, Discussion Paper No. 10-29, 2010); Edmund-Philipp Schuster, *The Mandatory Bid Rule: Efficient, After All?*, 76(3) MODERN L. REV. 529 (2013).

[3]Throughout this Article, we prefer to term this regime as the General Offer Rule instead of the Mandatory Bid Rule for the convenience of comparing it with the Partial Offer Rule, the main theme of this Article.

[4]Countries outside the European Union also adopt the General Offer Rule include Australia, Hong Kong, Singapore, Turkey, etc.

minority shareholders and preventing the transfer of the target's control to a looting acquirer. The battle between these two rules has lasted for decades, and it is still continuing on both sides of the Atlantic.

What is less noticed is the third control transaction regime, a middle way that we term the "Partial Offer Rule." Countries currently adopting the Partial Offer Rule include Japan, South Korea, China, and Taiwan, which are significant economic powers. Under the Partial Offer Rule, if an acquirer *plans to* purchase the target's controlling block of shares, it cannot conduct it privately. Instead, it must initiate a tender offer procedure offering to purchase *either all or part* of their shares from all the target's shareholders. Despite the obvious difference between the Partial Offer Rule and the General Offer Rule,[5] many comparative studies tend to group these two rules together in a single concept of "mandatory bid rule" or "sharing rule" without making clear distinction. In fact, we find little argument, if any, having been made specifically for the Partial Offer Rule.[6] Moreover, in countries implementing the Partial Offer Rule, we find a number of associated critics; some of which even propose the abandonment of this Rule.[7] Nevertheless, to the extent that the Partial Offer Rule appears to be a middle way that balances the facilitation of control transaction as advocated by the Market Rule and the protection of equal treatment of minority shareholders as advocated by the General Offer Rule, we believe this middle way model deserves attention, and we wish to fill this gap.

In this Article, we explore the Partial Offer Rule both in theory and in practice. As to theory, we apply the analytical framework adopted by contemporary studies and probe the effect of the Partial Offer Rule on

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[5]We will discuss this difference in *infra* Section II.A.1.

[6]For earlier literatures making some case for the Partial Offer Rule, *see* Andrews, *supra* note 2, at 505 (although Andrews' analysis focused on "sharing rule" which mixes the General Offer and Partial Offer Rule). For a more recent article illustrating the rationale underlying the Partial Offer Rule as implemented in Canadian Ontario, *see generally* Edward M. Iacobucci, *Why Does Ontario Require Equal Treatment in Sales of Corporate Control?*, 58 U. TORONTO L.J. 123 (2008).

[7]For critics of the Partial Offer Rule in Japan, *see* Tomotaka Fujita, *The Takeover Regulation in Japan: Peculiar Developments in the Mandatory Offer Rule*, 3 UT SOFT L. REV. 24, 40-43 (2011). For critics in China, *see generally* JUAN CHEN, REGULATING THE TAKEOVER OF CHINESE LISTED COMPANIES: DIVERGENCE FROM THE WEST 67-97 (2014); Charlie Xiao-Chuan Weng, *Lifting the Veil of Words: An Analysis of the Efficacy of Chinese Takeover Laws and the Road to a "Harmonious Society,"* 25:2 COLUM J. ASIAN L. 180 (2012); Wei Cai, *The Mandatory Bid Rule in China: Is It a Necessity*, 12:4 EUR. BUS. ORG. L. REV. 653, 665-80 (2011); Hui Huang, *The New Takeover Regulation in China: Evolution and Enhancement*, 42:1 INT'L L. 153, 167-75 (2008).

fostering/blocking efficient and inefficient transactions.[8] While we demonstrate the high degree of resemblance of the Partial Offer Rule with the General Offer Rule, after adding the factor of cost of funds into the existing analytical framework, we prove the former's superiority to the latter. Moreover, to push further the inquiry of the superiority of each regime, we also introduce a filter perspective that evaluates how each regime filters out inefficient transactions from efficient transactions and promotes the latter. We argue that the Partial Offer Rule, compared with the Market Rule and the General Offer Rule, is equipped with a better-functioning filter that imposes incentives on the incumbent controlling shareholder to select efficient transactions from inefficient ones. In contrast, we argue that the "filters" contained in the Market Rule (i.e. the fiduciary duty) and the General Offer Rule (i.e. minority shareholders' inaction) are relatively weak in reaching the same degree of effectiveness. We therefore argue that, to the extent that the target has an incumbent controlling shareholder, the Partial Offer Rule possesses some theoretical advantages.

As to practical aspects, on the other hand, we highlight several problems encountered in countries that have implemented the Partial Offer Rule. We introduce a number of transactional strategies adopted in the real world that would circumvent the Partial Offer Rule. We also conduct comparative studies of the exemption events implemented in different countries and highlight some controversial ones that would frustrate the spirit and purpose of the Partial Offer Rule. Overall, we find the Partial Offer Rule appealing in theory, but putting theory into practice is always challenging.

This Article is structured as follows: In Part II, we will describe in more detail the Partial Offer Rule, in particular its content, characteristics, implementation and variation in a number of East Asian countries. We will highlight the uniqueness of the Partial Offer Rule, especially its difference with the General Offer Rule, with the goal of presenting a clearer picture of this less-noticed regime.

In Part III, we will assess the theoretical foundation of the Partial Offer Rule. We first clarify the benchmark used to evaluate different control transaction regime. Specifically, we adopt an efficiency-centered lens and advocate that any form of protection of minority shareholders should be further assessed by its functional terms. In addition, such function forms should center on whether a protection may increase the value of the company and thus derivatively benefit all shareholders. Based on this established benchmark, we conduct economic analyses to

[8]We will discuss the definition of "efficiency" as used in this Article in *infra* Section III.A.

demonstrate the resemblance of the Partial Offer Rule with the General Offer Rule. That being said, we expand the current analytical framework by factoring in the cost of funds and prove the former's superiority to the latter. We then analyze how the Partial Offer Rule, through its *pro rata* purchase rule, incentivizes the incumbent controlling shareholder of the target company to select the acquirer in a more careful manner. Based on this analysis, we compare the filter mechanism contained in the Market Rule, General Offer Rule, and Partial Offer Rule and derive our conclusion that the filter under the Partial Offer Rule may be more effective in theory.

In Part IV we introduce how market players compromise the Partial Offer Rule by numerous ways of circumvention in practice. We refer to some ideas learned from the experience of the Partial Offer Rule camp, and we discuss several regulatory instruments needed for refining the Partial Offer Rule.

Through this Article, we wish to contribute to contemporary studies of control transaction regimes by bringing the Partial Offer Rule into the spotlight. While we do not intend to suggest the absolute superiority of the Partial Offer Rule to other regimes, we do believe this regime deserves more attention.

II. THE PARTIAL OFFER RULE: A MIDDLE WAY BURIED IN CONTEMPORARY DEBATES

To obtain control over a target company, an acquirer may either engage in a merger or acquisition to consolidate the target's business or asset into its own business. Another approach is to conduct a control transaction, which is a share acquisition, to obtain control over the target. Although these two types of transaction are similar in functional terms, their nature differs. Mergers and acquisitions in essence are transactions between the acquirer *and the target company*, under which the acquirer purchases the company or the company's business or assets. This requires the target to make a corporate decision—the board must pass a resolution and shareholders may be entitled to a vote. In contrast, control transactions in essence are private transactions between the acquirer *and the target company's shareholders*, under which the acquirer purchases the shareholder's asset, (i.e. their shares). In ordinary cases, the target's corporate decision is not required.[9] This major difference results in a

[9]Davies & Hopt, *supra* note 2, at 225-26. There are, however, some discussions of whether the target board's approval should be required for proceeding a control transaction, especially when the shareholding structure of the target is dispersed. *See* Luca Enriques et al.,

separate legal regime for control transactions. For instance, unlike mergers and acquisitions, control transactions typically neither require shareholder votes nor trigger appraisal rights of dissenting shareholders for their exits.[10]

Despite their differences with mergers and acquisitions, control transactions alter the target's controller and lead to fundamental change of the target's management and operational policy. These affect the target's value. If the target already has a controlling shareholder in place, control transactions also trigger coordination problems between the acquirer and the target's non-controlling shareholders and agency problems between the controlling and non-controlling shareholders.[11] These factors all warrant an inquiry into whether control transactions call for some form of regulatory controls. As mentioned above, comparative studies have devoted considerable attention to two main regimes for control transactions—the Market Rule and the General Offer Rule. To

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The Case for an Unbiased Takeover Law (with an Application to the European Union), 4 HARV. BUS. L. REV. 85, 93-94 (2014).

[10]We, however, do note that, some jurisdictions award dissenting shareholders the appraisal right in control transaction, and some commentators propose it. In the United States, Pennsylvania, Maine and Utah all provide similar "control share cash-out statutes." Consider 15 PA. STAT. & CONS. STAT. ANN. § 2546:

> After the occurrence of the control transaction, any holder of voting shares of the registered corporation may, prior to or within a reasonable time after the notice required by section 2545 (relating to notice to shareholders) is given, which time period may be specified in the notice, make written demand on the controlling person or group for payment of the amount provided in subsection (c) with respect to the voting shares of the corporation held by the shareholder, and the controlling person or group shall be required to pay that amount to the shareholder pursuant to the procedures specified in section 2547 (relating to valuation procedures).

Due to the limited paragraph, however, our following analysis will temporarily set aside these discussions. For some introduction of the minority shareholders' appraisal right in acquisition of control, *see* STEPHEN KENYON-SLADE, MERGERS AND TAKEOVERS IN THE US AND UK – LAW AND PRACTICES 186-87 (2004); Bebchuk, *supra* note 2, at 982-83.

[11]Davies & Hopt, *supra* note 2, at 229. To be sure, we do not intend to claim that the concentrated shareholding structure is inferior. A concentrated company may incur the agency problem between the controlling and non-controlling shareholder, but it may also incur less agency problem between the management and shareholders. In the end it is a tradeoff. For associated analysis, *see e.g.*, Lawrence A. Hamermesh & Michael L. Wachter, *Rationalizing Appraisal Standards in Compulsory Buyouts*, 50 B.C. L. REV. 1021, 1033, 1047-49 (2009) ("The obvious benefit of having controlling shareholders is that agency costs are reduced because the interests of the controller are more aligned with the corporation."); *see also* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L. J. 560, 566, 586-98 (2016).

supplement them, in this Article we focus on the third model that is equally prevalent in the world: the Partial Offer Rule.

A. *The Partial Offer Rule in the Landscape of Comparative Corporate Law*

1. Overview of the Partial Offer Rule

The Partial Offer Rule contains two main elements: the mandatory bid requirement and the *pro rata* purchase. As to the mandatory bid element, under the Partial Offer Rule, an acquirer who plans to acquire a controlling interest in the target is legally required to make a public tender offer. This means that this acquirer is forbidden from purchasing shares from specific shareholders in a private setting. Instead, it must make a public offer to all shareholders to purchase, at a fixed stated price, shares that are tendered during a stated period of time.

For instance, assuming that A has no shareholding of Company B and plans to acquire 60% of Company B's issued shares, which has reached the controlling level. Assuming further that C is Company B's current controlling shareholder and holds 60% of the Company B's issued shares. In such case, A cannot purchase the control over Company B by simply purchasing 60% shares from C. To realize its acquisition plan, A must do it through a tender offer procedure under which it makes public offer to Company B's all shareholders.

As to the *pro rata* purchase element, under the Partial Offer Rule, an acquirer may opt for a partial bid, meaning that it is permitted to make a public offer to purchase only part of the target company's shares.[12] In cases where the amount of the shares tendered from the target's shareholders exceeds that which the acquirer plans to purchase, the acquirer is under no obligation to purchase all the tendered shares. Rather, the acquirer may purchase shares from all the shareholders tendering their offer on a *pro rata* basis, determined by the planned acquisition amount divided by the total tendered amount then multiplying each shareholder's tendered amount.

For instance, following the example in the preceding paragraph, assuming that A has made a tender offer to Company B's shareholders, while 80% of Company B's shares tender their shares, A does not need to purchase all of the 80% tendered shares. Instead, it can stick to its purchase plan and purchase only 60% of Company B's shares. In such

[12]To be sure, under the Partial Offer Rule, an acquirer is certainly free to purchase the target's all shares. The Partial Offer Rule only permits acquirers to purchase part of the target's shares, not mandates so.

case, all tendering shareholders may only sell 75% of their tendered shares—the planned acquisition amount (60%) divided by the tendered amount (80%). To further illustrate the *pro rata* purchase rule in another instance, if maintaining the above assumptions, except that now A has already held 10% of Company B's shares and intends to purchase another 50% to make its holding 60%, under the Partial Offer Rule, A still has to initiate a tender offer, but in such case the tendering shareholders only get to sell 62.5% of their tendered shares—the planned acquisition amount (50%) divided by the total tendered amount (80%).

While the Partial Offer Rule is similar to the General Offer Rule to the extent that acquirers are similarly obliged to initiate a tender offer procedure, it contains two major differences. Under the General Offer Rule, the acquirer is legally required to purchase all of shares tendered by the target company's shareholders. This obligation does not exist under the Partial Offer Rule. Under the Partial Offer Rule, the acquirer need not purchase the shares exceeding the amount that it plans to acquire; in the event that the tendered amount exceeds the targeted amount, the *pro rata* purchase rule described above applies. Therefore, the acquirer has more flexibility under the Partial Offer Rule.

In addition, unlike the two-phase, *ex post* acquisition process under the General Offer Rule, the mandatory tender offer procedure under the Partial Offer Rule is one-phase and *ex ante*. To illustrate it, under the General Offer Rule, an acquirer can purchase the planned amount of shares through a private transaction in the first phase and subsequently initiate a tender offer to purchase remaining shares in the second phase. In this setting, the mandatory tender offer is an *ex post* procedure in the sense that it is initiated *after* the acquirer obtains a control block. In contrast, under the Partial Offer Rule, once the acquirer "plans" to purchase the target's shares above the controlling threshold, any private transaction is prohibited. Instead, the acquirer must implement its plan through a single tender offer procedure, and the mandatory tender offer is an *ex ante* procedure in the sense that it is initiated *before* the acquirer obtains the control.

2. The Partial Offer Rule Camp: Japan, South Korea, China, and Taiwan

While the Partial Offer Rule is less noticed in current comparative studies, in the real world a number of countries implement it as their control transaction regime. Here we select four major countries that

apply the Partial Offer Rule: Japan, South Korea, China, and Taiwan, each representing different path of evolution.[13]

a) Japan: A Pioneer with Shaky Faith

Among the Partial Offer Rule camp, Japan is perhaps the leader.[14] Initially, Japan adopted the Market Rule similar to the U.S. system, under which no mandatory bid rule was required. In 1990, Japan introduced the Partial Offer Rule into the amended Japanese Securities Exchange Act, which stipulates that if an acquirer intends to obtain more than one third of the target's shares, it is obliged to make the acquisition by means of tender offer, although the acquirer is free to determine the amount of shares that it wishes to purchase.[15] This reflects the spirit of the Partial Offer Rule.

In 2006, Japan amended its law in a significant way. The title of the law was changed from the original Securities Exchange Act to the current Financial Instruments and Exchange Act. Japan retained the Partial Offer Rule in the new Act,[16] but it also added a provision that provides that an acquirer shall purchase all shares that are tendered if it obtains more than two thirds of the total voting shares of the target company.[17] This essentially introduced a second layer of the mandatory bid rule on top of the original Partial Offer Rule, which is in essence a General Offer Rule. The ostensible purpose of this amendment was to guarantee minority shareholders an opportunity to exit from the target company, which is similar to the rationale underlying the General Offer Rule as implemented in the European Union.[18]

In sum, Japan currently maintains a mixed two-track regime embodying both the Partial Offer Rule and General Offer Rule. If an acquirer plans to hold more than one third of the target's shares, the

[13]To be sure, while the examples we enumerate here are all East Asian countries, we are not making a geography-based argument that the Partial Offer Rule is a feature of East Asian corporate laws. Many East Asian jurisdictions adopt the General Offer Rule instead of the Partial Offer Rule, such as Hong Kong and Singapore, etc. There are also jurisdictions outside East Asia that adopt the Partial Offer Rule, for instance, Ontario, Canada. *See* Iacobucci, *supra* note 6 for an introduction of the mandatory bid rule in Ontario. Here we only wish to point out that there remains a big world outside the United States and European Union.

[14]For an English introduction of the Partial Offer Rule in Japan, *see generally* Fujita, *supra* note 7, at 24-28.

[15]Securities Exchange Act art. 27-2(1) (Japan).

[16]Financial Instruments & Exchange Act art. 27-2(1) (Japan).

[17]Financial Instruments & Exchange Act art. 27-14(4) (Japan).

[18]Fujita, *supra* note 7, at 33-34.

Partial Offer Rule applies. If its holding exceeds two thirds of the target's issued shares, however, the General Offer Rule applies.[19]

b) South Korea: A Forerunner Forced to Retreat

South Korea is another forerunner in the Partial Offer Rule camp, but its control transaction regime experienced significant challenges during the Asian Financial Crisis in the late 1990s. Before the Asian Financial Crisis, South Korea maintained a Partial Offer Rule known as the "50%-plus-one-share" rule. Under this rule, any acquirers who wished to hold 25% or more of the target's shares must acquire them through public tender offer and offer to purchase more than 50% of the target's shares. Because this rule in effect forced potential acquirers to purchase 50% plus one share of the target, which was a significant burden, it effectively protected incumbent controlling shareholders. Moreover, during the Asian Financial Crisis, due to this rule foreign investors were blocked from acquiring financially distressed Korean firms.[20] Consequently, under the pressure of the International Monetary Fund,[21] the amended Korean Securities and Exchange Act of 1998 abolished this rule, which was considered a big step of South Korea towards attracting foreign investment.[22]

Even though the 50%-plus-one rule was removed due to the Asian Financial Crisis, South Korea preserved a variant of the Partial Offer

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[19]There is in fact a third layer in Japan providing for a 5% rule, that is, if an acquirer plans to purchase more than 5% of the target's shares, it shall initiate a tender offer procedure to implement its plan. However, this 5% rule is not applicable when the acquirer buys the shares from less than 10 shareholders within 60 days, which is a big exception for the acquirer, rendering this 5% layer less applied. Financial Instruments & Exchange Act art. 27-2(1)(i) (Japan); Cabinet Order of Implementing the Financial Instruments & Exchange Act art. 6-2(3) (Japan).

[20]For some illustration, *see* Sung Wook Joh, *The Korean Corporate Sector: Crisis and Reform, in* KOREA'S ECONOMIC PROSPECTS: FROM FINANCIAL CRISIS TO PROSPERITY 116, 121 (O. Yul Kwon & William Shepherd eds., 2001); Hwa-Jin Kim, *The Case for Market for Corporate Control in Korea*, 8 J. KOREAN L. 227, 235-36 (2009).

[21]*See* Letter of Intent submitted by the Republic of Korea to the International Monetary Fund (Feb. 7, 1998), *available at* https:// www.imf.org/external/np/loi/020798.htm.

[22]Sang-Koo Nam et al., *Korean Securities Market in Transition, in* RISING TO THE CHALLENGE IN ASIA: A STUDY OF FINANCIAL MARKETS – REPUBLIC OF KOREA, 56, 64, 81 (Asian Development Bank, 1999). For commentators who considered it a mistake for South Korea to abolish the partial offer rule, *see* Bernard Black et al., *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 J. CORP. L. 537, 605-06 (2001) (discussing how South Korea abolished the mandatory offer rule to encourage takeover bids); Stephen J. Choi, *The Future Direction of Takeover Law in Korea*, 7 J. KOREAN L. 25, 42-43 (2007).

Rule in its current law.[23] Under the current Financial Investment Business and Capital Markets Act, which largely incorporates the rules of the old Korean Securities and Exchange Act,[24] if an acquirer intends to purchase the target's shares outside the securities market from ten or more persons within a six month period, and as a result its aggregate shareholding ratio reaches or exceeds 5%, it must initiate a public tender offer to do so.[25] The same obligation also applies to an acquirer that already holds 5% or more shares and intends to purchase additional shares from ten or more persons within a 6-month period.[26] The *pro rata* purchase rule is also well established in South Korea. An acquirer may choose to include in its public notice of tender offer and tender offer registration a condition that if the total number of tendered shares exceeds the proposed number of shares for the tender offer, it will only buy the stocks *pro rata* within the limit of the proposed number of shares for tender offer.[27] This 5% threshold rule is the remnant of the Partial Offer Rule in South Korea.

c) China: A Latecomer from Another Camp

China is another prominent example.[28] Initially, it adopted the General Offer Rule. Pursuant to Article 81 of the Chinese Securities Law of 1999 and Articles 13 and 23(2) of the Measures for the Administration of the Takeover of Listed Companies (the "Takeover Measure") of the 2002, an acquirer was required to extend the offer to all the target's shareholders to purchase all of their shares if it held 30% of a listed company's issued shares and continued to acquire shares. However, when China amended its Securities Exchange Law and the Takeover Measure in 2006, it abandoned the General Offer Rule and

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[23]For a brief introduction of the partial offer rule implemented in South Korea after the Asian Financial Crisis, *see* Kwang-Rok Kim, *The Tender Offer in Korea: An Analytic Comparison between Korea and the United States*, 10 PAC. RIM L. & POL'Y J. 497, 503-04 (2001).

[24]In 2009, South Korea promulgated the Financial Investment Business and Capital Markets Act and consolidated, among others, the Securities Exchange Act into the new Act. For a comprehensive introduction of the process and rationale of this consolidation, *see generally* Joon Park, *Consolidation and Reform of Financial Market Regulation in Korea: Financial Investment Services and Capital Markets Act*, 6:1 NAT'L TAIWAN U. L. REV. 91 (2011).

[25]Financial Investment Business & Capital Markets Act art. 133.3 (S. Kor.), Enforcement Decree of the Financial Investment Services & Capital Markets Act arts. 140.1 & 140.2 (S. Kor.).

[26]Financial Investment Business & Capital Markets Act art. 133.3 (S. Kor.).

[27]Financial Investment Business & Capital Markets Act art. 141.1.2 (S. Kor.).

[28]For English introduction of the Partial Offer Rule in China, *see generally* CHEN, *supra* note 7; Weng, *supra* note 7; Cai, *supra* note 7; Huang, *supra* note 7.

turned to the Partial Offer Rule. The claimed purpose was to "decrease the acquisition cost, reduce the acquirer's motive to circumvent the rules, avoid complicated approval procedure, and foster the acquisition of listed companies."[29]

Under Chinese law, if an investor holds 30% of the shares of a listed company *through trade in securities on the stock exchange* and continues to acquire shares, it must extend an offer to all of that listed company's shareholders to purchase all or part of their shares.[30] Similarly, if an acquirer has already held 30% or more of a listed company's issued shares *through private acquisition agreement* and continues to proceed with acquisition, it must extend a tender offer to that listed company's shareholders to purchase all or part of their shares, unless the State Council's securities regulatory authority exempts such offer.[31] The amended Takeover Measure also restates the above provisions in similar language.[32] The *pro rata* purchase rule is also well established. For acquirers who extend a partial offer, they must purchase the shares tendered by the target's shareholders in accordance with the conditions set forth in the takeover offer. If the amount of tendered shares exceeds the planned acquisition amount, the acquirer shall purchase the tendered shares on a *pro rata* basis.[33] These provisions embody the classic Partial Offer Rule.

d) Taiwan: A Variant That Implements An Unorthodox Threshold

Taiwan has also employed the Partial Offer Rule since 2002.[34] Under current Taiwanese laws, if any person, independently or jointly with another person, proposes to acquire a *certain percentage* of the total issued shares of a public company, it must make the acquisition by a

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[29]The Memorandum for Revising the "Takeover Measure" I.1 (China).

[30]Securities Law of the People's Republic of China art. 88 (China).

[31]Securities Law of the People's Republic of China art. 96 (China).

[32]Measures for the Administration of the Takeover of Listed Companies [Takeover Measure] art. 24 (China) provides that if through the trade in securities in the securities exchange an acquirer's holding of a listed company's shares has reached 30% and continues to increase its holding, the increase in holding shall be implemented by offer in the form of either general offer or partial offer. Article 47, Paragraph 2 of the Takeover Measure provides that if an acquirer's holding of a company's issued shares has reached 30% and continues to proceed with the takeover, it shall issue general or partial offer to that listed company's shareholders in accordance with laws, provided that the acquirer may apply from the Chinese Securities Regulatory Commission for exemption from offer.

[33]Takeover Measure art. 43 (China).

[34]For an English introduction of the Partial Offer Rule in Taiwan, *see* Ta-Wei Kuo, *A Comparative Study of the Underlying Policies behind the Taiwanese and U.S. Tender Offer Legislation*, 2:1 NAT'L TAIWAN U. L. REV. 1, 24-32 (2007).

public tender offer.[35] This percentage refers to cases where an acquirer who, individually or jointly with another person, intends to acquire within 50 days shares accounting for 20% or more of the total issued shares of a public company.[36] The *pro rata* purchase rule is also well-established under Taiwanese laws. "If the shares number to be sold has exceeded the projected shares number to be acquired, the offeror shall purchase the shares *pro rata* from all the tenderers."[37] These provisions altogether stipulate the mandatory bid and the *pro rata* purchase elements of the Partial Offer Rule.

What makes Taiwan's rules different with the typical Partial Offer Rule is that the obligation to initiate a tender offer will be triggered only when the acquirer plans to purchase 20% of the shares within 50 days. Hence, the threshold triggering the mandatory tender offer is unrelated to how many shares the acquirer will hold "after" the transaction, but how many shares the acquirer purchases "in" the transaction as well as how quickly the acquirer engages in an acquisition. In other words, the threshold is less about a controlling threshold than a transaction amount threshold. An acquirer can purchase as many shares as it wishes without triggering the mandatory bid rule as long as it purchases them through separate transactions with adequate intervals between each transaction. This makes the Taiwanese Partial Offer Rule an unorthodox one. That being said, to the extent that there is a *pro rata* purchase rule and the tender offer procedure is one-phase and *ex ante*, the Taiwanese control transaction regime still follows the basic line of the Partial Offer Rule.

B. *A Middle Way Missed in the U.S.-EU Dichotomized Debate*

Despite the presence of the Partial Offer Rule in many influential economic powers, it does not attract as much attention as the Market Rule and the General Offer Rule. Such less notice is in part because the two most influential economic powers (i.e. the United States and the European Union) utilize distinct regimes that occupy the two extremes of the spectrum and take up most of the spotlight.[38]

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[35]Securities Exchange Act art. 43-1(3) (Taiwan).

[36]Regulations Governing Public Tender Offers for Securities of Public Companies [Tender Offer Regulation] art. 11(1) (Taiwan).

[37]Tender Offer Regulation art. 23(1) (Taiwan).

[38]For articles comparing the U.S. model and EU model, *see e.g.*, Elhauge, *supra* note 2; Magnuson, *supra* note 2; Davis & Hopt, *supra* note 2.

1. Dichotomized Debate between the U.S. and EU Models

In this Section, we briefly introduce the Market Rule in the United States and the General Offer Rule in European Union.

a) The Market Rule in the United States

The United States implements the Market Rule and places minimal limitation on control transactions.[39] Despite some case law imposing an obligation on controlling shareholders to compensate other, typically minority, shareholders for foreseeable harms caused by the sale of control,[40] the U.S. courts have not adopted a general principle mandating the equal sharing of control premium between controlling and non-controlling shareholders.[41] Section 5.16 of the American Law Institute ("ALI") Principles of Corporate Governance summarizes the current control transaction regime in the United States: "a controlling shareholder has the same right to dispose of voting equity securities as any other shareholder, including the right to dispose of those securities for a price that is not made proportionally available to other shareholders."[42]

This does not mean that control transactions are subject to no regulatory controls in the United States. Two major valves govern control transactions in the United States. The first valve is the disclosure requirements provided under securities laws. Since the 1968 Williams Act, an acquirer which plans to acquire the target's beneficial ownership to more than 5% must, within 10 days after the acquisition, file with the U.S. Securities and Exchange Commission ("SEC") the Schedule 13D for disclosing required information.[43] Information that must be disclosed in that Schedule includes the acquirer's identity and background, the amount and sources of the funds for acquisition, and the purpose of the

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[39]For an introduction of the Market Rule in the U.S., *see* Schuster, *supra* note 2, at 535-39.

[40]The controversial *Perlman v. Feldmann* case may be the closest one to the mandatory bid rule. 219 F.2d 173, 178 (2d Cir. 1955), *cert. denied*, 349 U.S. 952 (1955). Andrews, for instance, argued that this case introduced a sharing rule into the U.S. and should be applauded. *See generally* Andrews, *supra* note 2. Easterbrook and Fichel, in contrast, disagreed with the court's reasoning and conclusion. Easterbrook & Fichel, *supra* note 2, at 716-19. For other discussion of this case, *see*, Richard W. Jennings, *Trading in Corporate Control*, 44 CAL. L. REV. 1 (1956).

[41]For subsequent U.S. cases denying the mandatory bid rule in the U.S. *see e.g.*, Essex Universal Corp. v. Yates, 305 F.2d 572, 576 (2d Cir. 1962); Zetlin v. Hanson Holdings, Inc, 48 N.Y.2d 684, 421 N.Y.S.2d 877, 397 N.E.2d 387, 388-89 (1979).

[42]1 AM. LAW. INST., PRINCIPLES OF L., CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 5.16 (1994).

[43]Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m (2012).

acquisition.[44] Then after, acquirers are under continual obligations to disclose, among others, further acquisition of the target's shares. If any material change occurs in the facts set forth in the Schedule 13D, including, but not limited to, any *material increase or decrease in the percentage of the class beneficially owned*, the acquirer shall promptly file with the SEC an amendment disclosing that change.[45] Such disclosure obligations, however, are not unique to the United States; other countries adopting different control transaction regimes also impose similar disclosure obligations on acquirers.[46]

The second valve relates to the state law fiduciary duties that are imposed on controlling shareholders. Under common law,[47] a controlling shareholder owes a fiduciary duty of the same kind as that owed by a director to the corporation. In control transactions, the fiduciary duty of the controlling shareholder includes making necessary disclosure concerning the transaction to other shareholders and, among others, "refraining from engaging in transaction with a purchaser who, *as apparent from the circumstances*, is likely to violate the duty of fair dealing . . . in such a way as to obtain a significant financial benefit."[48] The rationale for imposing such a fiduciary duty upon the target's incumbent arises out of two main concerns: that other shareholders are in a difficult position to prove the acquirer's breach of fiduciary duty, and the acquirer may be unable to fully compensate minority shareholders. So "the more efficient approach is to prevent the transaction in the first place."[49] In that sense, the incumbent's duty to minority shareholders is essentially derivative to the acquirer's duty. That is why case law is consistent that minority shareholder claims against the target's incumbent controller should not be accepted unless either the acquirer later on actually breaches the fiduciary duty or the acquirer's breach is prevented

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[44]*See* Schedule 13D, 17 C.F.R. § 240.13d-101 (2016).

[45]Rule 13d-2(a), 17 C.F.R. § 240.13d-2(a) (1998). More specifically, "[a]n acquisition or disposition of beneficial ownership of securities in an amount equal to [1%] or more of the class of securities shall be deemed 'material' for purposes of this section; acquisitions or dispositions of less than those amounts may be material, depending upon the facts and circumstances."

[46]For instance, within the Partial Offer Rule camp, Japan imposes disclosure and reporting obligation on "large-volume holder." *See* Financial Instruments and Exchange Act arts. 27-24 & 27-25 (Japan). Taiwan also imposes similar obligations on shareholders holding more than 10% of shares of a public company. *See* Securities Exchange Act art. 43-1(1) (Taiwan).

[47]*See e.g.*, Insuranshares Corp. v. Northern Fin. Corp., 35 F. Supp. 22, 27 (E.D. Pa. 1941); Gerdes v. Reynolds, 28 N.Y.S.2d 622, 649 (1941). For some comments of these cases, *see* Adolf A. Berle, Jr., *"Control" in Corporate Law*, 58:8 COLUM. L. REV. 1218-20 (1958).

[48]1 AM. LAW. INST., PRINCIPLES OF L., CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 5.16 (1994).

[49]*Id.* at 377.

by injunction or similar action from doing so initiated by minority shareholders.[50] In sum, by virtue of this special fiduciary duty, the U.S. regime wishes to reduce the rate that the target is sold to a looting acquirer.[51]

What warrants some emphasis here is that, under common law, the incumbent's such liability will not be imposed unless it is "apparent from the circumstances" that the acquirer is likely to violate the duty of fair dealing and obtain a significant financial benefit. According to the ALI's comment, "affirmative investigation by the controlling shareholder is not required in the absence of facts that would alert a reasonable person to the need for further inquiry" and "[t]he mere fact that the controlling shareholder receives a substantial premium for its shares, or that the purchaser has a general reputation for aggressive acquisitions, is not itself sufficient to trigger such an inquiry."[52] This is apparently a loose standard.[53]

Delaware case laws, the hub of corporate law in the United States, follow the same line. On the one hand, they acknowledge that the controlling shareholder of the target company is free to sell its majority bloc for a premium that is not shared with other shareholders.[54] On the other hand, they also recognize that a controlling shareholder owes fiduciary duty to the corporation and other shareholders.[55] To harmonize these two principles in the case of control transactions, Chancellor Allen in the leading case *Harris v. Carter* held that:

> while a person who transfers corporate control to another is surely not a surety for his buyer, *when the circumstances would alert* a reasonably prudent person to a risk that his buyer is dishonest or in some material respect not truthful, a duty devolves upon the seller to make such inquiry as a reasonably prudent person would make, and generally to

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[50] *Id.*

[51] For some critics of this fiduciary duty approach, *see* Easterbrook & Fischel, *supra* note 2, at 718-19.

[52] 1 AM. LAW. INST., PRINCIPLES OF L., CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 5.16 (1994).

[53] For a criticism of the U.S. Market Rule, *see* Schuster, *supra* note 2, at 537-38.

[54] *In re* Sea-Land Corp. S'holders Litig., 13 Del. J. Corp. L. 795, 803 (Del. Ch. May 22, 1987); Harris v. Carter, 582 A.2d 222, 234 (Del. Ch. 1990); Mendel v. Carroll, 651 A.2d 297, 305 (Del. Ch. 1994). *Cf* Abraham v. Emerson Radio Corp., 901 A.2d 751, 758 (Del.Ch. 2006).

[55] *See e.g.*, Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 109-10 (Del. 1952); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987); Kahn v. Lync Commc'n Sys., Inc., 638 A.2d 1110, 1113 (Del. 1994).

> exercise care so that others who will be affected by his actions should not be injured by wrongful conduct.[56]

This "reasonable suspicion" standard[57] is again a loose one for the incumbent controller. Specifically, the plaintiffs can hardly plead the case in practice. As clarified by Vice Chancellor Strine in *Abraham v. Emerson Radio Corp.*, "[a]t the very least, a plaintiff seeking to state a claim must plead facts that indicate that the controller *knew* there was a risk that the buyer was a looter or otherwise intended to extract illegal rents from the subsidiary, at the expense of the subsidiary's remaining stockholders."[58] Under this standard, incumbent controlling shareholders are rarely found liable for breaching fiduciary duties when selling their controlling blocks.[59] In sum, in line with the Market Rule, Delaware case laws take a relatively hands-off attitude toward control transactions.[60]

b) The General Offer Rule in the EU

The European Union adopted Directive 2004/25/EC (the "Takeover Directive") in 2004 introducing the General Offer Rule.[61]

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[56]Harris v. Carter, 582 A.2d 222, 235 (Del. Ch. 1990) (emphasis added).

[57]Coffee, *supra* note 2, at 379.

[58]Abraham v. Emerson Radio Corp., 901 A.2d 757, 762 (Del. Ch. 2006) (emphasis added).

[59]A notable exception was established in Harris v. Carter, 582 A.2d 222, 234 (Del. Ch. 1990). In that case, as Vice Chancellor Strine later on commented, the plaintiff had "pled specific facts creating an inference that the seller should have been suspicious of the buyer's honesty." Abraham v. Emerson Radio Corp., 901 A.2d, at 759 (Del.Ch. 2006).

[60]There are other implicit valves in the United States that may control the control transaction. For instance, Gilson and Gordon argued for a *de facto* valve, which is the fiduciary duty imposed on the target's board members. According to them, in a control transaction, the target's board effectively plays some roles that can facilitate or frustrate the transaction. For instance, a control transaction can hardly proceed if the target's board does not allow the acquirer to conduct due diligence of the target or does not lift the poison pill. To that extent, the target's board possesses a *de facto* approval power over a control transaction. Because in exercising this power the target's board owes fiduciary duty to the target and other minority shareholders, this fiduciary duty serves the third valve for controlling control transactions. *See* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PENN. L. REV. 785, 805-816 (2003). For another instance, Coffee argued that Delaware courts can control the control transaction through the appraisal claims or fiduciary claims against the acquirer initiated by the minority shareholders when the acquirer freezes out the minority shareholders after the control transaction. *See generally* Coffee, *supra* note 2.

[61]Council Directive 2004/25/EC [hereinafter "Takeover Directive"] art. 5, 2004 O.J (L 142) 12, 17 (EC). For an introduction of the negotiating history of the Takeover Directive, *see* Magnuson, *supra* note 2, at 228-234. For comments on the General Offer Rule as provided under the Takeover Directive, *see* Marccus Partners & Centre for European Policy Studies, *The Takeover Bids Directive Assessment Report* (MARKT/2010/10/F, 2012); Thomas

Under the Takeover Directive, if a party holds shares of a company that give it a specified percentage of voting rights and control, Member States shall ensure that such a party is required to make a bid addressed to all shareholders for *all their holdings* at an equitable price.[62] The Directive, however, does not specify exactly what amounts to a control transaction. Additionally, although requiring that the offer price should be "equitable," the Directive does not identify what price shall be offered to the target's shareholders.[63] These are left to the Member States' discretion. Member States are also permitted to determine the criteria for exempting the mandatory bid procedure.[64] In implementing the Takeover Directive, the United Kingdom, the leader of the European General Offer Rule, stipulates the controlling threshold as 30%.[65] Austria, Italy, Belgium, France, Germany, the Netherlands, and Spain also maintain the same threshold.[66]

There are two major justifications for the General Offer Rule.[67] First, the General Offer Rule can prevent coercive takeover. It is argued that, under the Market Rule that contains no mandatory bid obligations, an acquirer can coerce the target's minority shareholders to sell their shares. Specifically, the acquirer can threaten each minority shareholder that if it does not tender its shares in the first place while other shareholders do, after the acquirer acquires the target's control and launches a second round acquisition to acquire remaining outstanding shares, the acquisition price in the second round will be lower or will be comprised of unattractive consideration, such as junk bonds. This is

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Papadopoulos, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 LAW & FIN. MKT. REV. 525, 525 (2007).

[62]Takeover Directive at art. 5 (EC).

[63]Takeover Directive at arts 5.3 & 5.4 first paragraph (EC).

[64]Takeover Directive at art. 5.4 second paragraph (EC). Italy, for instance, takes advantage of this exemption and introduces some flavor of the Partial Offer Rule in its takeover regime. *See* Legislative Decree no. 58 of 24 Feb. 1998 Consol. L. on Fin., art. 106(4) and 107(1) (It.). For related discussion, *see* Johannes W. Fedderke & Marco Ventoruzzo, *The Biases of an "Unbiased" Optional Takeovers Regime: The Mandatory Bid Threshold as a Reverse Drawbridge* 30-31 (Eur. Corp. Governance Institute – Law Working Paper, No. 304/2016, 2016).

[65]And we do not think that the United Kingdom's future exit of the European Union (the so-called "Brexit") will affect its adoption of the General Offer Rule. After all, it was the United Kingdom that adopted the General Offer Rule in the first place and then promoted this rule to the European Union. Therefore, even if the United Kingdom exits the European Union, we believe that the United Kingdom will continue implementing the General Offer Rule, just as it did before it entered the European Union.

[66]For a summary of the General Offer Rules as implemented in European countries, *see generally* CMS Cameron McKenna LLP, *CMS Guide to Mandatory Offers and Squeeze-outs* (Apr. 2011), *available at* http://www.cms-cmck.com/CMS-Guide-to-Mandatory-Offers-and-Squeeze-outs/.

[67]*See* Davies & Hopt, *supra* note 2, at 252-53.

known as a two-tiered-front-end-loaded tender offer.[68] It operates by creating a "prisoner's dilemma."[69] Fearing the unattractive consideration in the second round, minority shareholders feel pressured to tender their shares in the first round. However, such tendency is a distorted choice and does not reflect rational decision of most shareholders.[70] The General Offer Rule can prevent such coercion because of the mandatory bid obligation plus the equitable price requirement. Together, these two requirements guarantee minority shareholders that even if they wait until the second round, the acquisition price they will receive remains equitable instead of coercive. In this aspect, the General Offer Rule allows shareholders to make rational decisions and thus better protects minority shareholders' interests.

Second, the General Offer Rule can prevent value-decreasing transactions. It is argued that an acquirer's purpose of acquiring the target is not always value-increasing. It could be the case that the acquirer simply aims to loot private benefits from the target (such as tunneling the target's asset into its own pocket) instead of enhancing the target's corporate performance. As long as an acquirer does not hold 100 percent of the target's shares, such extraction can be profitable to the acquirer because the corporate value that the acquirer loots from the target always exceeds the acquirer's loss in the target's share price from such extraction. To illustrate it, on the one hand, the acquirer tunnels 100 percent of that extracted value into its own pocket. But on the other hand, while such extraction also reduces the target's value and therefore the target's share price, which should also result in loss to the acquirer to the extent of the acquirer's shareholding of the target, the acquirer's share price loss is not equal to 100 percent of the extracted value as other shareholders of the target will also incur some losses. In fact, the less share the acquirer holds, the more profits it can reap by tunneling the target's value.[71] Corporate law regimes can try to prevent looting

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[68] *See* Lawrence A. Hamermesh & Jacob J. Fedechko, *The Role of Judicial Opinions in Shaping M&A Practice*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 248-49 (Claire Hill & Steven Davidoff Solomon eds., 2016) (discussing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), and two-tiered tender offers).

[69] *Id.*

[70] For discussions of the distorted choice of minority shareholders, *see e.g.*, Lucian Arye Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98:8 HARV. L. REV. 1693, 1717-18 (1985); Lucian Arye Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 925-27 (1987); Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 55-56 (2005).

[71] For instance, assuming that A Company issues 1 million shares, of which B holds 0.75 million shares. If B tunnels $1 million of A's asset into B's own pocket, A Company suffers a loss of $1 million and its share price should decrease $1 (i.e. $1 million tunneled asset divided by $1 million total issued shares). Through this tunneling, B earns $1 million; although the value of its A's stock also reduces, the total loss to B is only 0.75 million (i.e. $1

behaviors by imposing, for instance, fiduciary duties on the controller,[72] but these legal regimes have their limits.[73] By adopting the General Offer Rule, acquirers are forced to acquire more shares of the target, which decreases the acquirer's incentive to loot the target's value. In particular, if all shareholders tender their shares to the acquirer, looting brings no profits to the acquirer. In light of that, looting acquirers may find acquisition less profitable and thus exit the capital market, leaving the market with more value-enhancing acquirers. In this aspect, the General Offer Rule can screen out value-reducing acquirers and leave the market with more value-enhancing acquirers.

2. The Missing Piece: the Partial Offer Rule

Others have provided an in-depth comparative analysis between the Market Rule and the General Offer Rule. Early discussion focused on whether the minority shareholders of the target company deserve equal treatment, be it in the form of entitlement to the control premium of the target, the right to participate in the sale of their shares, or the opportunity to exit the target when the target experiences change of control.[74] Professor William Andrews, for example, promoted the principle of equal treatment and argued that control transactions should follow similar rules in the M&A context, i.e. "inside and minority stockholders share alike; the insiders get no bonus to reflect the greater investment value of their holdings."[75] Other commentators oppose this sharing rule.[76]

Recent discussions shift the focus to the efficiency dimension, which concentrates on the efficiency costs of these two rules in terms of

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reduced share price times 0.75 million that is B's total amount of shareholding). The difference, i.e. $0.25 million, is undertaken by A's other shareholders. The fewer shares that B holds, the more profits it makes from tunneling A's assets. In any event the tunneling is worthwhile.

[72]This is what Easterbrook and Fichel advocates, *see* Easterbrook & Fichel, *supra* note 2, at 717-19.

[73]For a brief account of how the legal constraint strategies encounter their limits, *see* Luca Enriques et al., *The Basic Governance Structure: The Interests of Shareholders as a Class, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, *supra* note 2, 55, 79-81.

[74]Thomas L. Hazen, *The Sale of Corporate Control: Towards a Three-Tiered Approach,* 4 J. CORP. L. 263, 269-74 (1979) (a summary of the early discussion of the control theory, especially the arguments in favor of the sharing rule).

[75]Andrews, *supra* note 2, at 535-36.

[76]*See e.g.*, Easterbrook & Fischel, *supra* note 2 at 698; Hansen, *supra* note 2 at 298; Levmore, *supra* note 2; Elhauge, *supra* note 2 637-38.

blocking efficient transactions and permitting inefficient transactions.[77] On this aspect, Professor Lucian Bebchuk provides a comprehensive analytical framework for assessing how each control transaction rule impacts efficient and inefficient transactions. He first clarified that both the acquirer's and the incumbent's interests are comprised of two elements: the corporate value of the target and the private benefit looted from the target. He then conducted an economic analysis to demonstrate the condition for the incumbent and the acquirer to reach a deal under both the Market Rule and the General Offer Rule. By defining efficient transactions as those control transactions that transfer the target to an acquirer which brings more corporate value to the target, he demonstrated that the Market Rule may introduce more efficient transactions but also more inefficient transactions, while the General Offer Rule prevents all inefficient transactions but also more efficient transactions.[78] On this basis, Professors Paul Davies and Klaus Hopt argued that while the General Offer Rule can discourage looting acquirers, it also blocks control transactions in general, which is undesirable especially in countries with a concentrated shareholding structure because it makes it even more difficult to eliminate incumbent controlling shareholders.[79] Professor Edmund-Philipp Schuster, in contrast, held different position: he applied Bebchuk's analytical model to scenarios involving competing bidders and demonstrated that, when competing bidders exist, the General Offer Rule is more efficient than the Market Rule.[80]

In these threads of discussion, we find the Partial Offer Rule somehow muted. Most literature does take note of the existence of the Partial Offer Rule as a distinct regime from the Market Rule and the General Offer Rule. Nevertheless, in most cases, commentators simply treat the Partial Offer Rule as a variation of the General Offer Rule and mix them together, which downplays the independent character of the Partial Offer Rule.[81] In the end, we fail to observe much discussion

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[77]To be fair, earlier discussions also touched upon the efficiency dimension, *see* Andrews, *supra* note 2, at 517-19; Javaras, *supra* note 2, at 425-27.

[78]*See* Bebchuk, *supra* note 2 at 957-58. *See generally* Kahan, *supra* note 2.

[79]Davies & Hopt, *supra* note 2, at 258-59.

[80]*See generally* Schuster, *supra* note 2 at 556-57.

[81]For instance, Davies and Hopt did mention the Japanese Partial Offer Rule at the beginning, but later on their discussion focuses on the Market Rule in the United States and the General Offer Rule in European Union countries. *See* Davies & Hopt, *supra* note 2 at 234-35. Schuster also classified Japan's and Canada's Partial Offer Rules as a variation to the General Offer Rule rather than an independent category. *See* Shuster, *supra* note 2, at n.9.

devoted specifically to the Partial Offer Rule.[82] This Article intends to fill the void.

III. THEORETICAL FOUNDATIONS OF THE PARTIAL OFFER RULE: TRANSFORMING THE DICHOTOMIZED DEBATE INTO A TRICHOTOMIZED ONE

In this Part, we will compare the three control transaction regimes, namely, the Market Rule, the General Offer Rule, and the Partial Offer Rule, but will engage in more independent assessment of the latter. In particular, we expand Bebchuk's analytical framework by adding the factor of cost of funds, which makes a more convincing case for the Partial Offer Rule. We then employ a filter perspective to demonstrate the theoretical advantage of the Partial Offer Rule, especially its built-in "filter" mechanism designed on the basis of the incumbent controlling shareholder's "skin in the game."

A. *A Confirmation of the Benchmark to be Applied: An Efficient Term*

Before proceeding to the economic analysis, we have to determine the analytical approach to be applied. In our view, the dichotomized debate between the Market Rule and the General Offer Rule can be boiled down to a struggle between the protection of minority shareholders and the facilitation of control transactions. On the one end, the General Offer Rule affords more protection to minority shareholders by, for instance, providing them equal opportunity to sell their shares and exit the target company, according them entitlement to control premium, and protecting them from coercive acquisitions. On the other end, the Market Rule performs better in facilitating control transactions, which permits more value-decreasing deals but also more value-increasing deals as well. To determine which one dominates in the end may be simplified into asking if a country is willing to pursue more control transactions and sacrifice protection of minority shareholders or instead favor the other interest.

In our view, this give-and-take in essence is a welfare creation versus fairness debate, and in the field of law and economics such debate is common.

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[82]One exception is Bebchuk's article, which provides an independent analysis of the Partial Offer Rule, but his ultimate finding still considers the Partial Offer Rule generally identical to the General Offer Rule. *See* Bebchuk, *supra* note 2, at 968-71.

1. Equality or Efficiency? A Functional Term of the Protection of Minority Shareholders

On the battle between welfare and fairness, Professors Louis Kaplow and Steven Shavell have set forth the normative framework of welfare economics,[83] arguing that the evaluation of legal rules should be entirely based on welfare economics and give no weight to the notion of fairness.[84] They downplay the significance of "fairness," arguing that fairness is an incomplete concept that lacks concrete basis for determining its scope of application.[85] They further argue that the concept of "fairness" is nonconsequentialist in the sense that it often pursues a particular outcome from an *ex post* perspective but ignores how a given rule will pose *ex ante* effect on the affected individuals' behaviors and reshape the structure and well-being of the affected individuals.[86] Overall, they are skeptical of applying a fairness framework when designing laws, especially when the pursuit of fairness will not further the well-being of affected individuals.

We apply this observation to the area of corporate laws. The concept of equal treatment of shareholders may in itself be a virtue. However, what makes this concept a valid principle should be its functionality, especially its function as an incentive strategy that binds the controlling shareholder and "motivates her to act in the interests of shareholders as a class, which includes the interests of minority shareholders."[87] To elaborate, in the corporate world, shareholders are the primary group affected by corporate law, especially when they involve the Type II agency cost, i.e. the conflict of interest between controlling shareholders and minority shareholders.[88] While the well-being of an individual is difficult to define in principle,[89] defining the well-being of shareholders in the corporate world is relatively simple. That is, considering that corporations can be generally understood as

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[83] *See generally* LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE (2002).

[84] *Id.* at 3-4.

[85] *Id.* at 45-46.

[86] *Id.* at 47-51.

[87] Luca Enriques et al., *The Basic Governance Structure: Minority Shareholders and Non-shareholder Constituencies, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, *supra* note 2, 89, 96-99 (Enriques et al. further illustrate that "all jurisdictions rely on this device over at least some set of circumstances to align the incentives of controlling and minority shareholders.").

[88] John Armour et al., *Agency Problems and Legal Strategies, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, *supra* note 2, 35, 35-36.

[89] Because under welfare economics the well-being of an individual is not limited to monetary interest, but "everything that an individual might value" that is unrestricted to hedonistic and materialistic enjoyment. *See* KAPLOW & SHAVELL, *supra* note 83, at 18-24.

profit-seeking entities and that shareholders investing in a company generally aim to seek profits, shareholder well-being can be simplified into financial interests derived from the company they invest in. This well-being in financial terms can be in turn simplified into the company's value because shareholders have residual claims against the company's value. When a company's value increases, its shareholders benefit through either the increase in dividend or the increase in the value of their shares in open markets; an increase in either impacts shareholder financial well-being. From this perspective, if equal treatment or any protection of minority shareholders is of any virtue, it should be because these principles incentivize the company's controlling shareholder to maximize the company's value and thereby benefit all shareholders. If, to the contrary, equal treatment or any protection of minority shareholders in the end reduces a company's value, such claimed "equal treatment" or "protection" does not really protect minority shareholders because it simply reduces the well-being of all shareholders. In light of the above, we are skeptical of over-emphasizing the idea of protection of minority shareholders or equal treatment of minority shareholders *per se*.

To be sure, we are not saying that one should not be sympathetic of minority shareholders' interest. Our position is rather to question: what is the exact meaning of "fairness" or "equal treatment" of shareholders?[90] In the context of control transactions, a control transaction regime implicates the allocation of interest between those shareholders having access to private transactions (usually the incumbent controlling shareholder) and other left-out shareholders (usually the minority shareholders). It is unclear to us why distributing the interest originally accrued to the former to the latter is more equal. The concept of equal treatment is too abstract to reach definite conclusion.[91] Absent inquiries into its functionality, we fail to see how the concept of "fairness" or "equal treatment" sheds adequate light for answering this question.

Similarly, we do not find traditional inquiries centered on the assignment of the target's control premium valid.[92] Again, without considering functionality, there is absent concrete criteria for

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[90]Enriques et al., raised the same question and observed that "[i]nsofar as shareholder preferences are heterogeneous and controlling shareholders have legitimate power to shape corporate policy, some level of unequal treatment seems endemic to the corporate form." Enriques et al., *supra* note 87, at 96.

[91]*Id.* at 96-99 (observing that "the reach of the equality norm varies greatly, both within and between jurisdictions.")

[92]For a subtle analysis of how the principle of equal treatment differs with the control premium concept when applying to the case of control transaction, *see* Andrews, *supra* note 2, at 526-27.

determining which party should be assigned the control premium. The assignment of the control premium in fact resembles a "zero-sum" game between minority shareholders and the controlling shareholder: one party's earning is the other party's loss, and in this game we fail to see why minority shareholders should necessarily prevail. Borrowing the wisdom of Kaplow and Shavell, the assessment from an *ex post* perspective that focuses on which way of assigning the control premium is fair or just is insufficiently grounded. What we should assess instead is, from an *ex ante* perspective, which way of assigning the control premium will change the behavior of related individuals and thus maximize the well-being of every individual.

Arguments centering on the exit right of minority shareholders appear incomplete to us as well. As long as the target is a public company and does not go private immediately after the acquisition, its minority shareholders always retain a venue to exit the target, that is, selling their shares in the public market. Hence, the real problem is less about the opportunity to exit *per se* than the exit price. To illustrate, let us assume that the market perceives that the hypothetical acquirer is an inefficient controller. With that perception, the post-acquisition market price should be lower than the acquisition price because the market anticipates a poorer performance of the target under the inefficient acquirer's control. In that case, which price should be the "fair" exit price, the acquisition price or the market price? The General Offer Rule appears to award minority shareholders the acquisition price while the Market Rule leaves them only with the post-acquisition market price. One could argue that, to afford better protection to minority shareholders, laws should provide minority shareholders the higher price, i.e. the acquisition price. However, "more" is not necessarily "fair." One could make an equally convincing argument that minority shareholders should receive only the lower market price because they are not guaranteed profits in the public market and they should be responsible for their own investment judgment. Again, without further inquiry into functionality, we have little ground for deciding whether minority shareholders should be entitled to an exit right upon control transactions and how much the exit price should be.

To sum up the above, we prefer to assess control transaction regimes from the perspective of efficiency.[93] This assessment will largely follow the analytical framework developed by Bebchuk which evaluates whether a control transaction regime fosters more efficient transactions while at the same time precludes more inefficient

[93]For literature holding a similar view, *see e.g.*, Javaras, *supra* note 2, at 428; Easterbrook & Fichel, *supra* note 2, at 703-04, 715-19.

transactions. The following question would then be: how to define efficiency?

2. Company-Centric or Investor-Centric? Corporate Value or Stock Value?

In determining if a transaction is efficient or inefficient, Bebchuk assesses if a control transaction increases the target company's value. If a transaction transfers the target's control to an acquirer creating more value to the target compared with the incumbent controlling shareholders, it is an efficient transaction because it increases the value of the target company.[94] This increase in value is socially desirable because it maximizes the society's aggregate well-being, and it also benefits all shareholders, including minority shareholders, because the increase of the target's value will raise the target's stock price and accordingly benefit all shareholders. Under this framework, if a control transaction regime does not offer equal treatment to minority shareholders, but fosters more efficient transactions and/or precludes more inefficient transactions, even though minority shareholders are not vested with any nominal entitlement, such a regime is worth pursuing because eventually the well-being of all shareholders is improved. To the contrary, if a regime provides minority shareholders with various nominal entitlements but in effect blocks more efficient transactions and/or fosters more inefficient transaction, all these entitlements are merely empty vases. Hence, the assessment of different control transaction regimes shall focus on which one brings more value to the target company. We term this approach as a "company-centric" benchmark as what it concerns is the company's value.

While we generally agree with the above deduction, we wish to highlight another benchmark in addition to the company-centric one, that is, an "investor-centric" one. To elaborate, under Bebchuk's analytical framework, a company's value is comprised of two elements: (i) the value its controller creates minus (ii) the private benefits its controller extracts.[95] A controller who is good at creating value for the company can at the same time loot even more. Introducing such an acquirer does not necessarily benefit other non-controlling shareholders; they could in the end be worse-off. For instance, assuming Company A, under the incumbent controlling shareholder B, produces corporate value of $1 million, while A issues 1 million shares and B holds 0.6 million of them. Assuming now B plans to sell all of its shares to the acquirer C who is

[94]Bebchuk, *supra* note 2, at 963.
[95]*See id.* at 961-64.

able to produce $1.2 million corporate value but will also extract 0.4 million into its own pocket. This control transaction is value-increasing because A's value will increase for 0.2 million. However, the share price before the acquisition is $1 per share, while that after the acquisition will be only $0.8 per share. To A's other non-controlling shareholders, this claimed "value-increasing" transaction is nothing but value-decreasing. Should control transaction regimes allow this type of transaction? If we adopt the company-centric view, perhaps the answer is affirmative. In such a case, we see a discrepancy between corporate value and stock price.[96] Deciding which one should serve the metric to be maximized then requires further discussion.

If we adopt standard economic analysis using a rather simple measures of social welfare and accord no importance to the distribution of utilities,[97] one might prefer the company-centric view. The rationale is as follows: law and economics aims at maximizing the overall well-being of the society. In the corporate world, this is done by maximizing each individual company's value so as to in aggregate increase the society's well-being. In this aspect, introducing a value-increasing controller to each individual target is of importance because this ensures the target is being managed in a manner maximizing its value. In contrast, whether the controller loots from the target matters little, if any, because looting activities are only about the allocation and distribution of corporate value, not about the creation of corporate value, therefore not a concern under the metric of social well-being maximization.[98] From that perspective, one might prefer introducing a value-increasing but looting acquirer. Even if other non-controlling shareholders thus become worse-off, standard economic analysis might consider it a worthwhile tradeoff.[99] While this position is straightforward in the sense that it embraces one clear benchmark—i.e. social wealth maximization—it less considers allocative efficiency and distributional justice and thus may be susceptible to attacks.[100]

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[96]In fact, some literatures do suggest to place primary emphasis on shareholders' stock returns, *see e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 35-36 (1991).

[97]STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 3-4 (2004) (summarizing the basic reasons for standard economic analysis to ignore distribution concerns, such as leaving this issue to income tax and transfer system).

[98]Moreover, one might argue that corporate rules may have little effect on distribution of income because most investors will be on each side of a type of transaction equally often. KAPLOW & SHAVELL, *supra* note 83, at 33.

[99]For instance, Bebchuk's analytical framework appears to adopt this company-centric view. Bebchuk, *supra* note 2, at 963.

[100]For further discussion of the seriousness of distribution issues under economic analysis framework and how to tackle distribution issues within this framework, *see, e.g.*,

Modern welfare economists do not attempt to downplay the importance of distributional justice. They are concerned with the potential welfare effect that may be caused by distributional injustice and take into account such effects when calculating the overall well-being of the society. For instance, Kaplow and Shavell are cautious of over-extending welfare maximization arguments. They emphasize over and over again that their preference for welfare maximization only holds in a setting where the pursuit of fairness does not make *any* affected individual better-off or makes *everyone* worse-off.[101] If a policy increases the aggregate well-being of the whole society but makes "some" affected individual worse-off, they take no specific position. In particular, they acknowledge that fairness can have its independent value which in turn has effects on individual well-beings, and this should be factored in when assessing the overall well-being of the society.[102] Applying that understanding here, perhaps one cannot characterize the loss of non-controlling shareholders caused by looting as a distributional issue and simply ignore it. Instead, one should consider the welfare effect of the non-controlling shareholders' loss.

Specifically, perhaps one should consider not only the non-controlling shareholders' loss of interest *per se*, but also other potential spillover effects that could lead to efficiency loss. For instance, consider the impact on the sustainability of capital markets. If a control transaction regime is designed in a manner that tends to be disadvantageous to non-controlling shareholders, public investors may become less willing to enter into the stock market, resulting in a less vibrant capital market. This is why protection of minority shareholders and investors is always a crucial topic in corporate and securities laws. If taking that spillover effect into account, perhaps the investor-centric view, in addition to the company-centric view, is another dimension in need of attention. Admittedly, it may be difficult to quantify the actual cost of the spillover effect caused by inadequate protection of minority shareholders for determining the overall welfare gain or loss. But still, we believe this investor-centric view of at least equivalent importance when assessing different control transaction regimes.[103]

ANTHONY B. ATKINSON, INEQUALITY: WHAT CAN BE DONE? (2015); JOSEPH E. STIGLITZ, THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE (2013).

[101] *See, e.g.*, KAPLOW & SHAVELL, *supra* note 83, at 52.

[102] *Id.* at 394-96.

[103] There are in fact some literatures instead adopting this investor-centric approach and looking at the stock price when developing their analytical frameworks. *See, e.g.*, Easterbrook & Fichel, *supra* note 2, at 707-08.

Throughout the remainder of this Article, we will bear in mind the different implications of these two views when we evaluate the "efficiency" of different control transaction regimes.

B. *Economic Analysis of Different Control Transaction Regimes*

Among the three control transaction regimes we are going to compare, one might intuitively consider the Partial Offer Rule in the middle between the Market Rule and the General Offer Rule. Whether this intuition is true, however, requires more nuanced assessment.

1. Conditions for Reaching a Deal under Each Regime

Let us invoke Bebchuk's analytical framework first to make the comparison.[104] We start our analysis from the Market Rule.

a) The Market Rule

Assuming that a target company T, which issues X amount of shares, is with an incumbent controlling shareholder I who holds Y amount of T's issued shares (Y is smaller than X, meaning that T has other non-controlling shareholders). Assuming further that the incumbent creates value of V_I in total for A, but it also loots private benefit of P_I in total from A. In such scenario, the well-being per share of the incumbent (denoted as W_I) and other non-controlling shareholders of the target (denoted as W_{NI}) is as follows:

(1) $W_I = (V_I - P_I) / X + P_I / Y = (V_I + (X/Y - 1) \times P_I) / X$; while
(2) $W_{NI} = (V_I - P_I) / X$

If now there is an acquirer A who plans to acquire T's control by acquiring shares from I. Assuming further that A creates value of V_A in total for T, but it also loots private benefit of P_A in total from T. After the acquisition, the well-being per share of the acquirer (denoted as W_A) and that of other non-controlling shareholders of T (denoted as W_{NA}) is as follows:

[104] Our analytical framework basically resembles that of Bebchuk, except that we conduct our analysis from an aggregate lens built on assumed total value and total private benefit, while Bebchuk's analysis is from an average lens built on assumed value per share and private benefit per share. The result, however, should not be different. *See* Bebchuk, *supra* note 2, at 961-65.

(3) $W_A = (V_A + (X/Y - 1) \times P_A) / X$; while
(4) $W_{NA} = (V_A - P_A) / X$

Under the Market Rule, which imposes barely any restrictions on the transaction between I and A, a deal can be reached as long as $W_A > W_I$, because in that case the acquirer A is willing to offer price higher than the incumbent controlling shareholder I's well-being. That is:

$(V_A + P_A \times (X/Y - 1)) / X > (V_I + P_I \times (X/Y - 1)) / X$; that is,
(5) $V_A - V_I > (X/Y - 1) \times (P_I - P_A)$ (while $X/Y - 1$ by definition is > 0)

Under this condition, one finds that the Market Rule cannot block all value-decreasing transactions. To illustrate it, based on Function (5), it is apparent that even if V_A is less than V_I, which makes the left part of the function negative, there remains a likelihood that the above condition is met. That is, as long as P_A exceeds P_I significantly enough to make the right part of the function more negative, the condition can still be met. To put this differently, even if the acquirer is unable to create more *corporate* value than the incumbent controlling shareholder, as long as it can derive more *personal* value from the target by extracting the target's value into its pocket, it is willing to pay a high acquisition price that is attractive to the incumbent, and the deal can thus be reached between both parties.

Under both the company-centric and the investor-centric lens, this is not desirable. The company-centric lens disfavors these transactions simply because these transactions transfer the target to a controller that decreases the value of the target, which is against the objective of corporate value maximization. The investor-centric lens disfavors them because these transactions transfer the target to a new controller who is not only value-decreasing but also more looting, and these two elements, combined together, simply reduce the target's stock price. That said, the Market Rule simply cannot block these inefficient control transactions.

On the other hand, one can find that, under the condition of Function (5), the Market Rule blocks some efficient control transactions as well. To illustrate it, under Function (5), even if V_A is more than V_I, a deal cannot be reached if P_I is significantly higher than P_A. That is, if the incumbent controlling shareholder loots too much value from the target, it may be so deeply interested in its control over the target that it becomes unwilling to give up control. This is again undesirable under both the company-centric and the investor-centric lens. For the former, this means that some value-increasing deals cannot be reached, which is again against its objective of corporate value maximization. For the

latter, this means that the Market Rule may block a transaction that transfers the target from a low-value-more-looting incumbent controller to a high-value-less-looting acquirer, a transaction that increases the stock price of the target and benefits all shareholders. That said, the Market Rule still blocks these efficient transactions.[105]

b) The General Offer Rule

Now we turn to the General Offer Rule. The impact of the General Offer Rule on the incumbent controlling shareholder remains the same with that of the Market Rule. That is, the incumbent's right to sell its controlling block is not directly hindered by the rule. Therefore, the incumbent's well-being per share under the General Offer Rule remains the same with that as shown in Function (1). In contrast, the acquirer is subject to more stringent restrictions: if it acquires a controlling block, it is obliged to make an offer to all non-controlling shareholders to purchase all shares they tender. In that case, the well-being per share of the acquirer differs with that as shown in above Function (3). To illustrate it, assuming that all non-controlling shareholders tender their shares to the acquirer, the acquirer will find it meaningless to loot any asset from the target because the looting simply equates switching its asset from its left hand to right hand. Absent the factor of P_A, the well-being per share of the acquirer should be now completely determined by the value it brings to the target, that is:

(6) $W_A = V_A / X$

In that setting, the condition for the incumbent controlling shareholder and the acquirer to reach a deal (i.e. $W_A > W_I$) should now look as follows:

$V_A / X > (V_I + (X/Y - 1) \times P_I) / X$; that is,

(7) $V_A - V_I > (X/Y - 1) \times P_I$ (while both $X/Y - 1$ and P_I by definition are ≥ 0)

Under this condition, because the right part of the function is by definition ≥ 0, a transaction cannot be reached unless the acquirer creates more value than the incumbent. Therefore, the General Offer Rule can guarantee to block all value-decreasing transactions. That is, unlike the Market Rule, which still permits some value-decreasing transactions, the

[105]The result so far resembles that of Bebchuk. *See id.* at 965-68.

General Offer Rule does not. This is desirable from the company-centric perspective. Moreover, it is also desirable from the investor-centric perspective: because only those value-increasing transactions can proceed under the General Offer Rule, while under the General Offer Rule the acquirer will not engage in looting as mentioned above, the transactions that are permitted under the General Offer Rule are necessarily those that increase the stock price of the target as well. In sum, the General Offer Rule promises that it only permits efficient transactions.

This sounds desirable, but it comes with a price. The General Offer Rule at the same time blocks *more* efficient transactions as well. Based on Function (7), for a transaction to be reached, the acquirer has to create not only more value than the incumbent does, but also additional value that exceeds the incumbent's private benefit to a significant level.[106] Most importantly, if we compare between Functions (5) and (7), it is apparent that acquirers under the General Offer Rule must create more additional values than those under the Market Rule in order to reach the deal. The additional value must surpass the total private benefits of the incumbent multiplied by a multiplier, not just the difference between both parties' private benefits. Therefore, the General Offer Rule should block more efficient transactions than the Market Rule does. This is undesirable from both the company-centric and the investor-centric perspectives. Keeping a target in the hand of an incumbent who brings less value to the company but loots more private benefit is not in line with either the objective of corporate value maximization or the objective of stock price maximization.[107]

That said, compared with the Market Rule, the General Offer Rule erroneously blocks more efficient transactions even though it also blocks more inefficient transactions.

c) The Partial Offer Rule

Now we turn to the Partial Offer Rule. Contrary to the General Offer Rule, the acquirer is less affected. It can purchase the target's shares in the amount equal to that under the Market Rule. Therefore, the acquirer's well-being per share under the Partial Offer Rule should be the

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[106]In fact, the fewer shares the incumbent controlling shareholder holds, the more additional value the acquirer needs to make. *See* Schuster, *supra* note 2, at 553 (stating the General Offer Rule, aka the Mandatory Bid Rule, "requires the buyer to 'compensate' outside shareholders for [private benefits of control] they do not currently enjoy.").

[107]The result so far resembles that of Bebchuk. *See* Bebchuk, *supra* note 2, at 968-69, 971-72.

same with that as shown in Function (3). In contrast, the incumbent controller's free exit under the Market Rule and the General Offer Rule no longer exists. As long as other non-controlling shareholders tender their shares, the controlling shareholder cannot fully sell off its shares and exit the target. Instead, the controller can only sell part of its shares in accordance with the *pro rata* rule. For the rest of the unsold shares held by the controller, their value depends on the performance and looting, if any, of the acquirer. If we assume for simplicity that all the target's non-controlling shareholders tender their shares, the well-being per share of the incumbent controlling shareholder should be analyzed as described below.

First, before the acquisition, the incumbent's well-being in aggregate is equal to its well-being per share as shown in Function (1) multiplied by its total shareholding Y, that is,

$$(8)\ (V_I - P_I) \times Y/X + P_I = (Y \times V_I + (X - Y) \times P_I) / X$$

Then, after the acquisition, due to the *pro rata* purchase rule, the incumbent is unable to sell all its shares. Instead, it retains part of its shares on a proportional basis: the exact amount would be:

$$(9)\ Y \times (1 - Y/X)$$

In addition, after the acquisition, the incumbent is not the controller of the target anymore. Now its well-being per share is the same with other minority shareholders, that is, the well-being per share of non-controlling shareholders as shown in Function (4). Therefore, its post-acquisition well-being in aggregate should be this figure multiplied by its shareholding as shown in Function (9), that is,

$$(10)\ [(V_A - P_A) / X] \times Y \times (1 - Y/X) = (V_A - P_A) \times Y/X^2 \times (X - Y)$$

The difference between (8) and (10) then represents the well-being that the incumbent loses during the acquisition, and we can then calculate its well-being per share lost due to the acquisition by dividing that difference by the amount of shares it sells in the tender offer, that is,

$$(11)\ [[(Y \times V_I + (X - Y) \times P_I) / X] - [(V_A - P_A) \times Y/X^2 \times (X - Y)]] / (Y^2/X)$$
$$= V_I / Y + ((X - Y) / Y_2) \times P_I - (X - Y) / XY \times V_A + (X - Y) / XY \times P_A$$

In order for both the acquirer and the incumbent to be willing to reach a deal, the well-being per share to the acquirer (as shown in Function (3)) must exceed the well-being per share of the incumbent lost in the acquisition (as shown in Function (11)), that is,

$$(V_A + (X/Y - 1) \times P_A) / X > V_I / Y + ((X - Y) / Y_2) \times P_I - (X - Y) / XY \times V_A + (X - Y) / XY \times P_A$$

After some processing, surprisingly the above function can be simplified as follows:

(12) $V_A - V_I > (X/Y - 1) \times P_I$ (while both $X/Y - 1$ and P_I by definition are ≥ 0)

Looks familiar? Unbelievably yet true, this condition is exactly the same with Function (7), that is, the condition for reaching a deal under the General Offer Rule. This finding might explain why others have disregarded the Partial Offer Rule. Bebchuk reaches the same conclusion and provides an intuitional account for this finding.[108] According to him, one explanation may be that the Partial Offer Rule is able to produce disincentives that discourage the acquirer from looting private benefit from the target.[109] To elaborate it in an intuitive manner, because the incumbent knows that after the acquisition its remaining shares will be subject to the looting of the acquirer, it will ask for compensation when selling its controlling block to the acquirer. Such compensation, due to the *pro rata* purchase rule, will further apply to other non-controlling shareholders' sale of their shares. In the end, whatever amount of private benefit the acquirer should loot from the target will be returned to the target's shareholders during the acquisition, which renders the acquirer's looting activities simply meaningless. In even more extreme cases, acquirers will act the same as those under the General Offer Rule, that is, refrain from looting any private benefits. In either way, the Partial Offer Rule's result will be identical to that of the General Offer Rule.

Bebchuk also shows that, by appropriate design of transaction structures, the General Offer Rule and the Partial Offer Rule is inter-

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[108] *Id.* at 969-71.

[109] *Id.* at 969-70; *see also* Andrews, *supra* note 2, at 532-33 (demonstrating that "a purchaser offer[ing] to buy less than all the shares . . . is in effect seeking to have his purchase financed by the stockholders whose shares he does not purchase[,]" therefore limiting the controlling stockholder's ability to "compel . . . minority stockholders to participate . . . to the same degree, proportionately, as he is willing to participate himself.").

changeable, rendering the condition for reaching a deal under each rule the same. One might argue that the General Offer Rule should impose more capital restraints on acquirers because acquirers are required to purchase all instead of only part of the target's shares. For acquirers that have limited availability to finance, this should be an extra cost. According to Bebchuk, however, the capital restraint on acquirers is less an issue. To produce the same result with that under the Partial Offer Rule, an acquirer subject to the General Offer Rule can either use a partially-held shell subsidiary to purchase all the target's stock or simply purchase all the target's stock then resell part of them.[110] To elaborate, an acquirer who has limited capital can simply borrow funds from a financier, use the borrowed funds to purchase all the target's shares, resell part of them, then use the resale proceeds to repay the financier. In this manner, acquirers subject to the General Offer Rule but wishing to retain only part of the target's shares can still mimic the result of the Partial Offer Rule. This also explains why the Partial Offer Rule reaches the same result with the General Offer Rule.

2. Partial Offer Rule versus General Offer Rule: Cost of Funds Tells

The above conclusion that the Partial Offer Rule is not significantly different with the General Offer Rule might sound counter-intuitive. Bebchuk perhaps made a logically sound argument by highlighting the role of outside financiers in this counter-intuitive result.[111] However, although the availability of financing alleviates some concerns, it cannot equate the purchase of a target's shares with the purchase of its partial shares perfectly. Here we identify one factor that would easily alter the conclusion: the cost of funds.[112]

It is obvious that the General Offer Rule and the Partial Offer Rule each imposes different level of total cost on acquirers. An acquirer has to purchase all the target's shares under the former while only part of them under the latter. This crucial factor, however, is largely ignored by other discussions.[113] Bebchuk's reasoning appears to assume that, in a

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[110]Bebchuk, *supra* note 2, at 970-71.

[111]Certainly, this requires a well-functioning capital market. In countries with incomplete capital market where lenders have proper doubts, this precondition cannot stand. *See* Javaras, *supra* note 2, at 422.

[112]To be sure, Bebchuk did mention the potential presence of some transaction costs that may be implicated during the process of converting the General Offer Rule into the Partial Offer Rule. *See* Bebchuk, *supra* note 2, at 971 n.13.

[113]For instance, Andrews mentioned that for acquirers who do not intend to extract private benefits, "[t]here will be no difference between his price per share for a bare controlling block, and his price per share for any larger amount." Andrews, *supra* note 2, at

market providing available finance, acquirers should be indifferent with this cost issue because they can obtain all necessary funds in the financial market as long as they can persuade others to be as optimistic of their acquisition plans.[114] This, however, only tells half of the story. While in either case the acquirer's acquisition plan can be funded, the cost of funds differs. If an acquirer funds its acquisition plan through loans or other debt vehicles, it has to undertake higher aggregate interest expense as the amount of debt increases. Even if an acquirer uses its own capital to fund the acquisition, it still needs to consider the opportunity cost incurred. The higher this cost of funds is, the more the two Rules should differ with each other.

To illustrate our point, assuming the unit cost of fund for purchasing each share is C. Adding this factor alters the well-being of acquirers under both Rules. Under the General Offer Rule, now the well-being per share of the acquirer is no longer that as shown in Function (6); instead, its cost of funds for purchasing X shares of the target needs to be taken into account, that is:

(13) $W_A = (V_A / X) - C$

Thus, for an acquirer to agree to the acquisition plan, the condition is altered from Function (7) to:

$(V_A / X) - C > (V_I + (X/Y - 1) \times P_I) / X$; that is,

(14) $V_A - V_I > (X/Y - 1) \times P_I + X \times C$ (while both $X/Y - 1$, P_I, X and C by definition are ≥ 0)

Compared with Function (7), this revised condition becomes even more difficult to be satisfied because the increased value the acquirer brings to the target needs to cover one more factor, i.e. the cost of fund.

On the other hand, under the Partial Offer Rule, the well-being of the acquirer is no longer the one shown in Function (3) as well. Instead, its cost of funds for purchasing Y shares of the target needs to be taken into account, that is,

(15) $W_A = (V_A + (X/Y - 1) \times P_A) / X - C$

528. This observation apparently ignores the cost of funds factor. In contrast, for literatures taking note of this factor. *See* Elhauge, *supra* note 2, at 640-41.

[114] *See* Bebchuk, *supra* note 2, at 970-71; *see also* Andrews, *supra* note 2, at 531-32 ("If the purchaser can convince others to share his optimistic view of the corporation's future under his control, then it can take the form of a simple participation by those others in the purchase.").

And the condition for reaching a deal under the Partial Offer Rule is then adjusted to:

$(V_A + P_A \times (X/Y - 1)) / X - C > V_I / Y + ((X - Y) / Y_2) \times P_I - (X - Y) / XY \times V_A + (X - Y) / XY \times P_A$; that is,

(16) $V_A - V_I > (X/Y - 1) \times P_I + Y \times C$ (while both P_I, $X/Y - 1$, Y and C by definition are ≥ 0)

After improving our analysis by adding the factor of cost of funds, we find that on the one hand, both the Partial Offer Rule and the General Offer Rule can still block all value-decreasing transactions as found before because the right part of the function is by definition above 0, which mandates $(V_A - V_I)$ above 0. On the other hand, a more crucial point is that, although both Rules block some value-increasing transactions, the Partial Offer Rule in effect blocks fewer. This is because, compared with Function (14), the condition set forth in Function (16) is relatively easier to be satisfied, considering that the aggregate cost of funds for purchasing a controlling block of shares (i.e. amount of Y) is by definition smaller than that for purchasing all shares (i.e. amount of X). Considering that the Partial Offer Rule blocks the same amount of inefficient transaction with the General Offer Rule does (that is, all inefficient transactions), but it permits more efficient transaction than the General Offer Rule does, the Partial Offer Rule should dominate the General Offer Rule.

The above observation can be illustrated by an intuitive account as well. As mentioned above, the General Offer Rule and the Partial Offer Rule are inter-changeable, and an acquirer subject to the General Offer Rule can mimic the result of the Partial Offer Rule if it wants. If so, why bother to impose the more stringent General Offer Rule in the first place? To the extent that imposing the more stringent General Offer Rule cannot prevent the result of the Partial Offer Rule, such imposition merely increases the transaction cost, which is a less efficient regime. In contrast, compared with the General Offer Rule, the Partial Offer Rule has the advantage of flexibility. An acquirer subject to the Partial Offer Rule can still opt to purchase all the target's shares and pursue the result of the General Offer Rule if it wants, while the law will not impose additional transaction cost on such pursuit. Therefore, if mandatory bid

rules are of any merit, they should be implemented in the way of the Partial Offer Rule rather than the General Offer Rule.[115]

In light of the above, we believe it a mistake for the mainstream comparative studies to use the General Offer Rule to represent the mandatory bid camp. In essence, the General Offer Rule is less efficient than the Partial Offer Rule, and we argue that the Partial Offer Rule should be more representative.[116]

3. Partial Offer Rule versus Market Rule: An Unsettled Question

When it comes to the comparison with the Market Rule, the dominance of the Partial Offer Rule is less than clear. The factor of cost of funds is less an issue because acquirers under both Rules expend the same for their acquisition plans.[117] The major difference still lies between Functions (5) and (12). In comparison, the Market Rule permits more efficient transactions in the market than the Partial Offer Rule, but it also permits more inefficient transactions.

To be fair, the difference between these two regimes may be less significant than what the functions says if one considers the fiduciary duty regime built in the Market Rule.[118] The major difference between conditions as shown in Function (5) and in Function (12) lies in the presence of P_A in the former. As discussed above, under the Partial Offer Rule, the acquirer's post-acquisition private benefit is not an influential

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[115]This probably explains why earlier U.S. literature on mandatory bid rules focused more on a set of sharing rules combining both the Partial Offer Rule and the General Offer Rule. Essentially, they were discussing the Partial Offer Rule. *See, e.g.*, Andrews, *supra* note 2, at 521.

[116]In addition to the factor of cost of funds, Elhauge identified another factor that distinguishes the General Offer Rule from the Partial Offer Rule: the different level of diversification. He mentioned that even if acquirers are able to fund their acquisition plans, they might not prefer the General Offer Rule as under this rule their investment risks are less diversified. Elhauge, *supra* note 2, at 640. If one adds that risk into our analytical framework, the dominance of the Partial Offer Rule over the General Offer Rule will be more significant.

[117]One may want to check if that is the case. To do so, the W_A under the Market Rule, which was originally described in Function (3) should be adjusted to Function (15). The condition for reaching a deal thus should be adjusted to: $(V_A + P_A \times (X/Y - 1)) / X - C > (V_I + P_I \times (X/Y - 1)) / X$, that is, $V_A - V_I > (P_I - P_A) \times (X/Y - 1) + X \times C$. Note, however, that here the cost of funds factor is multiplied by X instead of a smaller Y in the case of the Partial Offer Rule, which should thus narrow the difference between the two regimes. But because this difference is less prominent, the major difference lies in that between $(P_I - P_A) \times (X/Y - 1)$ and $(X/Y - 1) \times P_I$ as before.

[118]For literature advocating the Market Rule and placing the major hope on its fiduciary duty regime. *See* Elhauge, *supra* note 2, at 641-43. For a comprehensive introduction of the Delaware cases related to control transaction, which extends beyond the fiduciary duty of the incumbent controlling shareholder to other legal regimes, such as the appraisal regime and the fiduciary duty of the acquirer under freeze-out. *See generally* Coffee, *supra* note 2, at 378-96.

factor because either it does not exist in the first place or it is compensated during the acquisition. In contrast, it is present under the Market Rule, which affects the condition for reaching a deal. Based on these functions, one may further conclude that it is the presence of this post-acquisition private benefit that fosters more control transactions under the Market Rule. Function (5), however, does not tell the full story of the Market Rule.

Note that as introduced above, the Market Rule does not disregard completely the private benefit of the acquirer. It also imposes fiduciary duties on the incumbent controlling shareholders, which requires them to refrain from selling their control of the target to a looting acquirer.[119] This framework addresses the major difference of the Market Rule with other regimes, that is, the acquirer's post-acquisition private benefit. Assuming that the deterrent effect of this duty works so perfectly that incumbents will never sell the target to any looting acquirers, the P_A under the Market Rule will be zero. In that case, the condition for reaching a deal under the Market Rule as shown in Function (5) no longer needs to count in the non-existent P_A, meaning that it will be exactly the same with that under the Partial Offer Rule as shown in Function (12). In that ideal world, we no longer need to discuss which regime works better.[120]

At least two qualifications should be made here. First, it can hardly be expected that the fiduciary duties built in the Market Rule can function so well as to align the Market Rule and the Partial Offer Rule. The real world is in fact the other way around. Recall that the fiduciary duty imposed upon the incumbent is a pretty loose one. Given this rarely-functioning duty, one can hardly expect that P_A under the Market Rule will disappear. The presence of such fiduciary duty probably cannot improve the Market Rule as expected.[121] To that extent, the Market Rule's difference with the Partial Offer Rule still exists.

Second, even if the fiduciary duty is perfectly implemented, which eliminates altogether the post-acquisition private benefit of the acquirer and aligns the Market Rule with the Partial Offer Rule, the associated cost may differ. To illustrate this point, note that although under both

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[119]For related Delaware cases, *see, e.g.*, Abraham v. Emerson Radio Corp., 901 A.2d 751, 759 (Del. Ch. 2006); Harris v. Carter, 582 A.2d 222, 234-35 (Del. Ch. 1990).

[120]In addition, not only does the fiduciary duty imposed on the incumbents may help deterring the acquirer's looting behaviors, but also the fiduciary duty imposed on the acquirer can serve this function. Note that after the acquisition, the acquirer becomes the controller of the target and therefore undertakes the fiduciary duty imposed by case laws on controlling shareholders, including not to loot the company. Easterbrook and Fichel believe this latter type of fiduciary duty is the one that really protects the interest of minority shareholders. Easterbrook & Fichel, *supra* note 2, at 718-19.

[121]For similar observations, *see* Coffee, *supra* note 2, at 362-63.

regimes the P_A no longer exists, the way each regime reaches this result differs. Under the Partial Offer Rule, it is done through the mandatory requirement of tender offer, and the associated cost is mainly related to the tender offer process, including those incurred due to the preparation of prospectus, wait period, clearance, etc. In short, the cost would concern primarily the compliance toward the securities regulatory authority in each country. In contrast, under the Market Rule, the associated cost is mainly related to litigation, including those incurred due to the solicitation of lawsuit, evidence gathering or discovery, or even the risk of trial errors and necessity of appeal or retrial.[122] In other words, these costs mainly concern judicial activities in each country. While it is difficult to compare the magnitude of cost to be incurred under each case, the relative efficiency of the securities regulatory regime vis-à-vis court system of a given country will certainly matter.[123]

In sum, the Market Rule overall permits more control transactions because it imposes less legal restriction. However, for assessing the desirability between the Market Rule and the Partial Offer Rule, this observation is an incomplete answer. We need further analytical tools.

C. *A Comparative Study of Different Control Transaction Regimes from a "Filter" Perspective*

To disentangle the above puzzle, we provide a further analytical angle that focuses on the built-in "filter" mechanism of each control transaction regime.

1. Contemporary Literature on How to Assess the Desirability of Each Regime

After conducting associated economic analyses, contemporary studies of control transaction regimes remain plagued by the question of how to further determine the superiority between different regimes. Between the Market Rule and General Offer Rule, it is generally accepted that the former permits more efficient transactions but at the same time also more inefficient ones. In contrast, although the General Offer Rule can preclude all inefficient transactions, it also blocks more

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[122]For an economic analysis of the cost of litigation, *see generally,* SHAVELL, *supra* note 97, at 389-443.

[123]For instance, Andrews argued that the sharing rule that saves the litigation cost might be more efficient. Andrews, *supra* note 2, at 536-37.

efficient transactions. Thus, a simple answer would be: neither rule dominates the other.[124]

This observation is not surprising. The Market Rule imposes extremely minimal legal obstacles on control transactions, and thus it fosters basically all types of control transactions, be it efficient or inefficient. In contrast, the General Offer Rule imposes perhaps the most intensive restraints upon control transactions, and thus it certainly frustrates more control transactions, both efficient and inefficient ones. Without further analysis, this comparison will be boiled down to a simplified question of whether having more or fewer control transactions is more desirable. However, answering this question does not help in assessing the superiority between different regimes. Then how do we determine if it is the more the better or the fewer the better?

Some discussions have analyzed more subtly the actual effect of different control transaction regimes on efficient/inefficient control transactions.[125] For instance, Javaras stressed that, if under present laws most control transactions are inefficient, perhaps the General Offer rule may be superior, but the problem is that no one knows the magnitude and frequency of inefficient transactions under the current regime.[126] For those advocating the Market Rule, Easterbrook and Fichel applied the theory of portfolio diversification to argue that investors' risks associated with control transactions under the Market Rule is diversifiable, and thus investors should prefer rules that can bring more value to the target.[127] Barclay and Holderness provided empirical data collected from the United States and showed that control transactions were normally followed by the increase in stock price that favored all shareholders, which supports the transaction-friendly Market Rule.[128] Based on this empirical finding, Elhauge argued that over-deterrence rather than under-deterrence should be the real problem and thus advocated the less-regulated Market Rule.[129] Bebchuk also provided comprehensive analyses and put forward a number of hypothetical conditions for each rule to dominate the other.[130] For instance, one of his observations was

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[124]Bebchuk, *supra* note 2, at 974; Davies & Hopt, *supra* note 2, at 258-60.

[125]For earlier but less complete discussions, *see* Andrews, *supra* note 2, at 518-19.

[126]Javaras, *supra* note 2, at 422-23. For a similar position, which treated the issue here an empirical question, *see* Kahan, *supra* note 2, at 377.

[127]Easterbrook & Fichel, *supra* note 2, at 711-14. Bebchuk's analysis which proves that the Market Rule may incur less efficient cost in a market where the difference between pre- and post-acquisition value and that between pre- and post-private benefit looting are symmetric also lends support to this diversification argument. Bebchuk, *supra* note 2, at 975-76.

[128]*See generally* Barclay & Holderness, *supra* note 2 at 271-78.

[129]Elhauge, *supra* note 2, at 641-43.

[130]*See* Bebchuk, *supra* note 2, at 974-81.

that assuming that there are multiple rounds of control transactions, the Market Rule should be able to bring more targets to the controller that creates the most value.[131] For those advocating the General Offer Rule, on the other hand, Schuster made an insightful argument analyzing how the General Offer Rule introduces a more robust screening mechanism than the Market Rule when there is more than one bidder.[132]

In this Article, we propose an additional perspective. As discussed in previous paragraphs, the metric for comparing different regimes should be about to what extent each regime permits efficient transactions while blocks inefficient transactions. The above economic analyses, however, fall short of giving us the answer. Indeed, they provide us with the conditions for reaching a deal under different regimes, but these conditions only lay out a range within which transactions can take place. Exactly where within that range will individual transactions fall on is uncertain. Taking the Market Rule for instance, while based on Function (5) we know that the Market Rule permits both some efficient and some inefficient transactions in theory, in implementation, how many efficient versus inefficient ones proceed remains unresolved by the Function. One may wonder if each control transaction regime possesses some built-in mechanism that leaves the transactions permitted under its regime mostly efficient ones.

In our view, to produce that outcome, a control transaction regime should be able to distinguish between efficient and inefficient transactions and accord different treatments accordingly.[133] Unfortunately, to distinguish efficient transactions from inefficient ones *ex ante* is extremely difficult, if not impossible.[134] This is not like doing a math on the paper, with given figure showing the current value of the target under the incumbent controlling shareholder's control and the future value under the acquirer's control. It requires a forecast of the future in a real world, which is in itself subject to overwhelmingly unknown and uncontrollable factors in each individual case. This cannot be done through abstract rules or legislation bearing a general and *ex ante* nature. Instead, it requires the efforts and attention of related market players on a case-by-case basis. In this aspect, one way to compare different regimes may be boiled down to: how does each regime incentivize related market players to distinguish between efficient and inefficient transactions and accord differential treatment favoring the

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[131] *Id.* at 980-81.

[132] Schuster, *supra* note 2, at 554-57.

[133] Coffee held the same position. Coffee, *supra* note 2, at 364.

[134] Davies & Hopt, *supra* note 2, at 253.

former, and how efficient is such built-in incentive mechanism of each regime?[135]

2. The Partial Offer Rule's Use of the Incumbent Controlling Shareholder's "Skin in the Game" as a Filter

We start our inquiry from the Partial Offer Rule, the central theme of this Article. In our observation, the filter mechanism under the Partial Offer Rule relies on the incumbent controlling shareholder, the major affected party under this regime. This point may be illustrated by a comparison with the General Offer Rule. Under the General Offer Rule, acquirers are obliged to purchase whatever amount of shares tendered, thus the regime basically imposes the cost of funding on acquirers. In contrast, under the Partial Offer Rule, acquirers need not purchase all tendered shares. Its acquisition cost is thus essentially similar to that under the Market Rule.[136] Instead, the major party affected by the Partial Offer Rule is the incumbent controlling shareholder. This is because pursuant to the *pro rata* purchase rule,[137] the amount of shares that the incumbent can sell is in a negative correlation with the amount of tendered shares. The more other minority shareholders tender their shares, the less the incumbent may sell its shares. Therefore, under the Partial Offer Rule, the party who is placed to the forefront for protecting minority shareholders is the incumbent controller.

The Partial Offer Rule does take advantage of this feature to create a workable filter mechanism. Under the Partial Offer Rule, the incumbent is basically doomed to retain some shares of the target after the acquisition. The post-acquisition value of these retained shares then plays a significant role when the incumbent makes its cost and benefit analysis of whether to agree to the proposed acquisition. As shown in Function (11), when the incumbent decides whether to agree to the proposed acquisition, it wants to make sure that the aggregate price of the stock sold, together with the aggregate value of the retained stock after the acquisition (as shown in Function (10)), can exceed the aggregate value of all these stocks when the target is under its control. Following this logic, the higher the post-acquisition value of its retained

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[135]Elhauge raises similar inquiries in his article defending for the Market Rule. *See* Elhauge, *supra* note 2, at 631.

[136]To be sure, the acquirer's cost is not exactly the same. Under the Partial Offer Rule, the acquirer might further incur some costs associated with the tender offer procedure. However, in terms of the purchase price to be paid for acquiring the control of the target, it would be generally similar. *See* Elhauge, *supra* note 2, at 638-39 (referring to the General Offer Rule as the equal sharing approach).

[137]*See* Bebchuck, *supra* note 2, at 969 (for information on the *pro-rata* rule).

stocks, the more possible the proposed transaction reaches a deal (because the incumbent can tolerate a lower offer price). From this perspective, the post-acquisition value of the target's share is of tremendous interest to the incumbent under the Partial Offer Rule.

Nevertheless, the above economic analysis of the Partial Offer Rule in fact contains one implicit assumption, that is, the incumbent is aware of the target's future performance under the acquirer's control. Specifically, we assume that the incumbent has perfect knowledge of the post-acquisition value of the target's share. Only with that assumption can we run our inference to derive the condition for reaching a deal. In the real world, however, this assumption for most of the time does not stand true. In most cases, the incumbent does not possess perfect information regarding the post-acquisition value of the target's stock. To begin with, this value is a future value, which no one can perfectly predict. Besides, this value is derived from the target's post-acquisition stock price, which is comprised of two elements: the future corporate performance of the target and the private benefit to be looted by the acquirer. After the tender offer, however, the control over the target will be transferred to the acquirer, while the incumbent will lose its control. Therefore, how much value the acquirer will create for the target and how much private interest the acquirer will loot from the target is at the disposal of the acquirer, not the incumbent controller. The incumbent in this setting is in fact at an informational disadvantage. It does not know the future value of the target under the acquirer's control.

The incumbent, however, is incentivized to overcome this informational disadvantage. To the extent that the future performance of the acquirer affects the future well-being of the incumbent, a rational incumbent will not be indifferent with the acquirer's future performance when assessing whether to transfer its control to the acquirer. In this sense, the Partial Offer Rule mandates some "skin in the game" on the part of the incumbent controller, which creates an incentive for the controller to select between different acquirers. In particular, it incentivizes the incumbent to filter out inefficient acquirers and deal with efficient acquirers as possible. This benefits the target as well as its other non-controlling shareholders.[138]

Entrusting the incumbent controlling shareholder with this filter role is appropriate in terms of capacity. Among the players interested in the target's value, the incumbent is apparently more capable of

[138]For literatures making similar argument for the Partial Offer Rule, *see* Andrews, *supra* note 2, at 517-18. Although Elhauge favored the Market Rule, he also appeared to show some sympathy toward the Partial Offer Rule when he criticized the General Offer Rule. *See* Elhauge, *supra* note 2, at 644.

safeguarding the target. First, as the controller of the target, it has the most access to the target's information, including the general knowledge of the business and finance as well as specific knowledge of the target's current performance and business prospects, etc. Therefore, the controller has better information of what kind of replacement controller and what business plan best fit the target. Second, it has better access to the profile of the acquirer. To seek the incumbent's cooperation with its acquisition plan, the acquirer has to approach the incumbent through private negotiation before initiating the tender offer. This provides the occasion for the incumbent to understand the acquirer better, both the acquirer's capacity in improving the target's performance and likelihood of looting private benefits from the target. Finally, it has the bargaining power against the acquirer. To acquire the control over the target, the acquirer needs the incumbent's cooperation.[139] The incumbent thus has the say about whether the transaction may go forward. It even possesses the leverage to turn to other acquirers. If it is uncomfortable with its informational disadvantage as illustrated above and does not feel receiving adequate clarification from the acquirer, it can end the negotiation and walk away. With these relative advantages in inherent knowledge, access to information, and bargaining power, what the incumbent could possibly lack is only the incentive. But the Partial Offer Rule offers this last piece of the puzzle.

One might wonder if the acquirer can simply buy out the incumbent controlling shareholder. For instance, to seek the cooperation from the incumbent, can an inefficient acquirer simply raise the acquisition price to a level that "compensates" for the incumbent's future loss in stock value? One may argue that if the acquisition price is high enough, perhaps the incumbent would be less incentivized to act its filter role. This would be less likely the case, though, for two main reasons. First, from the incumbent's perspective, a higher acquisition price might not be a good thing necessarily. Note that the acquisition in the end has to be done through the tender offer procedure. The higher the tender offer price is, the more minority shareholders might tender their shares; then the fewer shares the incumbent may sell, and the more shares it has to retain. The incumbent thus would be exposed to the risk of stock price loss if the acquirer is inefficient. In this aspect, compensatory pricing does not necessarily provide comfort to the incumbent. Second, this acquisition strategy in fact represents a higher acquisition price and consequently a lower return to the acquirer. An efficient acquirer, aiming at maximizing its returns, would avoid using this strategy.

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[139]Davies & Hopt, *supra* note 2, at 256.

Instead, it would tend to demonstrate to the incumbent its ability to run the target efficiently. If an efficient acquirer manages to convince the incumbent, it is rewarded with a lower acquisition price. In contrast, an inefficient acquirer cannot demonstrate so and have to pay higher compensatory acquisition price. In this sense, the Partial Offer Rule not only incentivizes incumbents to monitor potential acquirers, but also incentivizes efficient acquirers to release more private information, which reduces the informational asymmetry problem.

3. Filter Mechanism of Each Control Transaction Regime

Bearing in mind that the filter mechanism of the Partial Offer Rule centers on the incumbent controlling shareholder, we now proceed to compare the filter mechanism of the Market Rule and the General Offer Rule.

a) The Market Rule: A Fiduciary Filter

The filter mechanism under the Market Rule in general consists of the fiduciary duty imposed on the incumbent controlling shareholder. In traditional dichotomized debate, the Market Rule's filter mechanism attracts some applause. We argue, however, that when considering the Partial Offer Rule and transforming the dichotomized debate into trichotomized debate, the advantage of the Market Rule fades.

As mentioned above, under the Market Rule, there is nearly absent any legal limitation to the incumbent controlling shareholder and the acquirer. Therefore, in normal course, the incumbent should concern only the acquisition price offered by the acquirer, without regard to the future performance of the target under the acquirer's control.[140] There is however one legal restraint, that is, the incumbent's fiduciary duty to other non-controlling shareholders of the target, in particular the duty to refrain from selling the company to an "apparent looter" as mentioned above.[141] In the dichotomized debate, one argument for the Market Rule

[140]While a higher future return of the target might render the acquirer viewing the target with higher value and thus willing to offer a higher acquisition price, it is not vice versa. A higher acquisition price does not represent that the acquirer is a more efficient one, because an acquisition price is composed of two elements: the future return of the target under the control of the acquirer and the acquirer's private benefits derived from the target. A higher acquisition price can be equally caused by the acquirer's tunneling of high private benefits, which is detrimental to the target and the target's shareholders. However, whether a high acquisition price is caused by a higher future return or a higher private benefit is unobservable in itself.

[141]To be sure, there are other legal restrictions in the United States that may prevent the acquirer from looting and thus reduce the rate of inefficient control transaction. For related discussion, *see generally* Coffee, *supra* note 2. In our view, these legal valves certainly

is that this fiduciary duty specifically imposes on the incumbent an obligation to screen acquirers carefully, which is a filter mechanism that retains efficient transactions while filters out inefficient ones. It is also a tailor-made law that applies to each individual case on a case-by-case basis and avoids the concern of over-generalization. This flexible legal design may better fit the objective of regulating the control transaction.[142]

However, here we raise three concerns of this fiduciary filter.[143] Our first concern relates to the practicability of this fiduciary filter. To be effective, the fiduciary filter requires an effective enforcement system, preferably a robust private enforcement environment. However, except for the United States, which has a robust plaintiff lawyer structure that is active in initiating fiduciary duty claims,[144] most countries in the world are relatively deficient in this aspect.[145] Absent an effective enforcement system to litigate against the incumbent, any fiduciary rule, regardless how perfectly-designed, is simply a "flower in the mirror or moon in the water", that is, an illusion. This might to some extent explain why countries implementing the Market Rule are relatively rare. For many countries, the Market Rule might be simply an "unaffordable luxury."

The second one relates to the clarity of this legal rule. As having been noted, the standard of the fiduciary filter here is a relatively vague one. The duty exists only when "the circumstances are apparent that" the acquirer will be a looter, while the incumbent in normal course is not obliged to initiate an investigation voluntarily. It is also far from clear as

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matter, but they more govern the business activities of the acquirer than regulate the control transaction *per se*.

[142]Elhauge, *supra* note 2, at 642-44.

[143]For literature that also casts doubts on the fiduciary filter, *see e.g.*, Andrews, *supra* note 2, at 518.

[144]For instance, Delaware courts recognize that a plaintiff shareholder may recover, under certain conditions, reasonable investigation fees from the defendant company, including the attorney fees in derivative lawsuits, which facilitates shareholder litigations in Delaware. *See* Bird v. Lida, Inc., 681 A.2d 399, 403 (Del. Ch. 1996). For more discussions of plaintiff attorney and shareholder litigation in the United States, *see generally* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law through Class and Derivative Actions*, 86 COLUM. L. REV. 669 (1986); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J. L. ECON. & ORG. 55 (1991); Reinier Kraakman et al., *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1733, 1736-37 (1994); Brian JM Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137 (2011); Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multijurisdictional Litigation*, 106:4 NORTHWESTERN U. L. REV. 1753 (2012).

[145]*See generally* Kenju Watanabe, *Control Transaction Governance: Collective Action and Asymmetric Information Problems and Ex post Policing*, 36:1 NORTHWESTERN J. INT'L L & BUS 45, 82-106 (2016) (for a comprehensive discussion of how the U.S. judicial system, especially the Delaware court system, lays down a solid foundation that supports the takeover regime in the United States).

to how the court should apply this "apparent circumstances" standard and when the incumbent should engage in an investigation to honor this duty.[146] Absent a clear and enforceable standard, this fiduciary filter might not be optimal for regulating the behaviors of the incumbent.

Our final concern relates to the adequacy of this legal rule. We note that the Market Rule and the Partial Offer Rule are similar to the extent that both rules place the incumbent controlling shareholder to the forefront. The difference is that, under the Market Rule, behaviors of the incumbent are guided less by business incentives than legal norms, under which the incumbent is legally required to refrain from engaging in transaction with an apparent looter.[147] However, even if an acquirer is not an apparent looter, it is likely an inefficient controller. Accordingly, it appears to us that the fiduciary filter is limited to an extremely narrow scope. However, to ascertain the future performance and looting potential of the acquirer, seems to call for intensive investigation. The modest nature of the fiduciary filter, therefore, risks under-deterrence. Moreover, this under-deterrence problem is less likely to be fixed by simply raising the fiduciary standard. In our view, the problem here is fundamentally about the limit of legal sanction. Fiduciary duty has to concede to a large extent to refrain from over-intervening into business affairs, and we have to admit that fiduciary duty does not and cannot capture all commercially undesirable conduct.[148] This is why the corporate governance of a company cannot merely rely on legal sanctions but needs other vehicles to incentivize related market players to act optimally.[149]

In light of the above, we doubt that the fiduciary filter of the Market Rule is the best filter.

b) The General Offer Rule: A Minority Shareholders Filter

We now turn to the General Offer Rule. In our view, the General Offer Rule also contains a filter mechanism, but an extremely dim one that relies on minority shareholders.[150]

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[146]Schuster, *supra* note 2, at 537-38.

[147]*Id.* at 537.

[148]For instance, as Schuster has noted, if adding the dimension of synergy, which in some occasions can be a private benefit of an acquirer but can hardly be challenged under any fiduciary regime, things become more complicated and the fiduciary duty here becomes less available. *See id.* at 543-46.

[149]For a comparison of the different strategies employed by corporate laws to address agency costs, *see generally* Armour et al., *supra* note 88, at 37-50.

[150]The incumbent controlling shareholder, on the other hand, plays minimal, if any, role under the General Offer Rule. As mentioned above, under the General Offer Rule, the incumbent may sell all their shares in the first-phase private transaction, meaning that it may

Under the General Offer Rule, the acquirer undertakes the cost to purchase all tendered shares. The scale of such cost, however, depends on how many minority shareholders in the end tender their shares. In the above economic analysis of the General Offer Rule, we made a big assumption, i.e. all non-controlling shareholders tender their shares in the second-phase tender offer. However, this is not necessarily the case. From a rational investor's perspective, whether to tender its shares depends on a comparison between the tender offer price and the future value of the shares. If an investor is convinced that the future value of its shares will exceed the tender offer price, it would prefer holding instead of tendering its shares. From this perspective, if the acquirer is expected to be so efficient that under its control the value of the target's share will be higher than the offer price, perhaps fewer minority shareholders would tender their shares. In this sense, an efficient acquirer should face less capital pressure than an inefficient acquirer under the General Offer Rule. To the contrary, if minority shareholders perceive that an acquirer is unable to create as much value to the target company as the tender offer price, they will tender their shares. Knowing this possibility, a less efficient acquirer would be less incentivized than an efficient acquirer to initiate the acquisition in the first place. In such manner, the General Offer Rule blocks inefficient transactions. Hence, under the General Offer Rule, it is the minority shareholders' perception of the acquirer that serves the filter.

Is it possible that the incumbent controlling shareholder considers the acquisition price high and prefers to sell their controlling block, while other minority shareholders consider the tender offer price relatively low and prefer to hold their stocks? Theoretically it is possible, as long as the future value of the target under the acquirer's control is expected to be greater than the target's current value to a significant level. For instance, assuming that the incumbent controlling shareholder controls 5 million of the 10 million issued shares of the target, and it brings $100 million profits to the target but also loots $20 million private benefit from the target. In that case, the unit share price of the target company under the incumbent's control would be $8 per share, while the value of the shares to the incumbent is $12 per share. Now here comes an acquirer who is able to create $160 million profits to the target and it only loots a $10 million private benefit. In such case, the unit share price of the target company will become $15 per share, while the value of the controlling block to the acquirer is $17 per share. Thus, the acquisition price

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leave no skin in the game after the acquisition. In light of this transaction structure, as long as the acquisition price is right for the incumbent controlling shareholder, it will sell its shares without regard to whether the acquirer is an efficient or inefficient one. *See id.* at 34.

acceptable to both the incumbent and the acquirer should range between $12 and $17 per share. However, if they reach the deal in between, say, $14.5 per share and therefore adopt this figure as the tender offer price, other minority shareholders might be reluctant to tender their shares, considering that the future value of the share is $15 per share. With fewer amount of tendered shares from minority shareholders, the acquirer may alleviate its capital pressure, the major defect of the General Offer Rule. Therefore, the scenario as contemplated in the previous paragraph is possible, at least theoretically.

Nevertheless, the above scenario is easier to be said than done. To realize this theory, minority shareholders must be able to evaluate the future performance of the acquirer in order to decide whether to sell or hold their shares. However, minority shareholders, compared with the incumbent controlling shareholder, are subject to apparently more serious informational asymmetry problem.[151] They have limited access to the private information possessed by the acquirer, and they have limited expertise, capacity, and time to consume related information. They are also subject to the typical collective action and free rider problems because each individual minority shareholder possesses a relatively small interest making the information-gathering process cost-inefficient. In light of all these factors, one can hardly expect minority shareholders to undertake the filter role well. In practice, what minority shareholders would tend to adopt as the reference against the offer price may be the current stock price, considering that this reference, as opposed to the forecast of the future value of the target, is relatively visible and simple. When the tender price appears higher than the current stock price, it is difficult, if not impossible, to expect minority shareholders to hold back their temptation to tender their shares on the belief that the target's future value will be higher.[152] To that extent, the minority shareholder filter under the General Offer Rule is less reliable.

c) The Partial Offer Rule: A More Functional Filter

Compared with the Market Rule and the General Offer Rule, we argue that the filter mechanism of the Partial Offer Rule, taking advantage of the target's incumbent controlling shareholder, is more functional. Compared with the minority shareholders filter of the

[151]Bebchuk also notes the informational asymmetry problem the non-controlling shareholders may face under the General Offer Rule. Bebchuk, *supra* note 2, at 973.

[152]Taking the above hypothetical case for example, how many minority shareholders can hold it back when the current unit share price of the target company is merely $8 while the acquirer offers $14.5?

General Offer Rule, the incumbent is at an apparently advantageous position in defending the future well-being of the target. Compared with the fiduciary filter of the Market Rule, the "skin in the game" design under the Partial Offer Rule, as opposed to the modest legal sanctions under the Market Rule, should better incentivize the incumbents to discharge their duty. Therefore, we argue that the Partial Offer Rule is, if not superior to, at least as theoretically valid as the other two rules.

One challenge made by current literature against the Partial Offer Rule focuses on its undesirable impact on both the incumbents and the acquirers. The challenge goes like this: for the incumbents, on the one hand, they might want immediate cash and do not want to retain their shares anymore. For the acquirers, on the other hand, they might not want a blockholder, after the acquisition, retaining considerable shares of the target and posing a threat to the acquirer's control. Due to these factors, the price for purchasing the incumbent's shares may differ with that for purchasing the same amount of shares but on a *pro rata* basis: the latter should be higher. By introducing these factors, the Partial Offer Rule may raise the capital requirement of control transactions and thus block more efficient transactions.[153] We do not deny that, under the Partial Offer Rule, acquirers may be forced to pay more. To the contrary, we appreciate the existence of a premium that compensates the incumbent and other non-controlling shareholders for their future loss and prevents the acquirers' future looting. Admittedly, it may block some efficient transactions, but at the same time it also blocks those inefficient transactions. Most importantly, this design forces the incumbent's stay in the target and thus incentivizes them to monitor the acquirers both *ex ante* and *ex post*. Compared with the Market Rule which provides less functioning filter mechanism, we argue that the Partial Offer Rule's filter has more teeth.[154]

IV. THE PARTIAL OFFER RULE IN THE REAL WORLD

By demonstrating the theoretical merits of the Partial Offer Rule in the previous part, we seem to portray a rosy picture of the Partial Offer Rule. In this Part, we will provide a realistic account of the real-world implementation of the Partial Offer Rule. In particular, we demonstrate

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[153] Javaras, *supra* note 2, at 425-26; Elhuage, *supra* note 2, at 640-41. *See also* Easterbrook & Fichel, *supra* note 2, at 708-11 (further identifying another separate factor, i.e. free-riding, associated with the sharing rule which may increase the capital requirement of control transactions).

[154] In fact, we find these literatures a bit over-emphasizing the efficiency-preclusion aspect but downplaying the inefficiency-encouragement aspect. *See, e.g.*, Javaras, *supra* note 2, at 425-26; Easterbrook & Fichel, *supra* note 2, 708-11.

how market players under the Partial Offer Rule regime accommodate their interests with this regime through both the design of transaction structure and the interference in rules making.

A. *Circumvention Through Design of Transaction Structure*

As mentioned above, the Partial Offer Rule prevents the incumbent controlling shareholder and the acquirer from engaging in private transactions according to their will. This increases the incumbent's risk because it cannot sell off all its shares but has to retain them for some period of time. It also increases the acquirer's cost because the acquirer has to not only undertake the tender offer costs but also tolerate the presence of a blockholder in its acquired company. Therefore, the incumbent and the acquirer will naturally want to collude with each other in innovating various ways to circumvent the Partial Offer Rule.

Below we introduce some ways of circumvention and some regulatory responses.[155]

1. "Stay-below-the-surface" Strategy

To implement the Partial Offer Rule, a country needs a threshold for defining if a transaction constitutes control transaction and triggers the mandatory tender offer obligations. One can simply define it by a substantial approach, covering whenever an acquirer plans to obtain the control of the target. Many jurisdictions, however, opt to adopt a formal approach, i.e. defining control as a specific numerical proportion of the target's issued shares. For instance, in Japan the numerical threshold is one-third of the target's issued shares, while in China it is 30% of the target's shares.[156] This approach certainly bears the clarity advantage, but it also incurs a conventional one-size-cannot-fit-all problem.

Apparently, a numerical threshold is a rough figure that risks over-generalization. No specific numerical threshold can represent the controlling threshold of each and every individual target. For instance, for a target with dispersed shareholding structures, perhaps an acquirer can obtain the control by acquiring only 15% of the issued shares. In contrast, for a target with concentrated shareholding structures, an

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[155]Our introduction here focuses on those circumvention related to the Partial Rule. For some introduction of the circumventions under the European General Offer Rule, *see generally* Jeremy Grant et al., *Financial Tunneling and the Mandatory Bid Rule*, 10(2) EUR. BUS. ORG. L. REV. 233 (2009).

[156]In Canadian Ontario, the threshold is 20%. Securities Act art. 89 (Ont.).

acquirer might find its holding inadequate even though it has acquired 45% of the target's issued shares. A rigid numerical threshold thus creates an easy way for acquirers and incumbents to circumvent the Partial Offer Rule. In particular for those targets with relatively dispersed shareholding structure, the acquirer and the incumbent controller can simply transfer the control while staying below the surface. This "stay-below-the-surface" strategy frustrates the purpose of the Partial Offer Rule, but it falls in the dead corner of the Partial Offer Rule.[157] Unless a country determines the controlling threshold otherwise,[158] this strategy is always a haunted problem.

2. "Small-leap" Strategy

If an acquirer cannot obtain the control over the target without acquiring more than the stipulated amount of shares, the "stay-below-the-surface" strategy does not work. This might be because the incumbent controlling shareholder holds too many shares that exceed the controlling threshold, or because the target has other blockholders and thus obtaining control requires more shares. In these cases, the acquirer and the incumbent, who are doomed to be subject to the mandatory tender offer obligation, might consider another strategy to reduce the impact of the mandatory tender offer procedure to minimal.

One strategy the acquirer and incumbent would consider is the "small-leap" strategy. To elaborate, the acquirer may privately purchase shares from the incumbent to an amount close to the numerical threshold in the first place and then initiate the tender offer procedure to purchase the remaining shares needed. For instance, if the numerical threshold is 30%, while the acquirer intends to purchase 32% of the target's shares, it

[157]To be sure, this defect is not unique to the Partial Offer Rule. The General Offer Rule faces the same challenge to the extent that a numerical threshold is employed for determining whether a second-phase tender offer procedure should be initiated. Similarly, an acquirer subject to the General Offer Rule can circumvent this mandate and thus frustrate the purpose of the General Offer Rule if it can obtain the control of the target by acquiring a below-threshold amount of shares. *See* Papadopoulos, *supra* note 61, at 527.

[158]We note that some countries adopting the General Offer Rule instead adopt the substantial approach. For instance, Italy used to stipulate that an acquirer is required to launch a tender offer if it *effects a change of control* of a listed company. Italy, however, repealed this criterion, out of the concern that it proved vague in practice. *See* Grant et al., *supra* note 155, at 250. Spain, on the other hand, still maintains the substantial approach by stipulating that if a party acquires shares of a Spanish company (but do not attain at least 30% of the voting rights therein) and, within the 24 months following that acquisition, appoint (or are deemed to have appointed) a majority of the company's board members, it is obliged to launch a tender offer procedure. Act 24/1988, of 28 July, on the Securities Market art. 60.2 (Spain). Some academic literature also appears to advocate the substantial approach. *See* Andrews, *supra* note 2, at 547.

may privately purchase 29% of the target's shares from the incumbent in the first place and then initiate the tender offer procedure to purchase the remaining 3%. Through this arrangement, in the tender offer procedure the acquirer only offers to purchase 3% instead of 32% of the target's shares, and the incumbent may circumvent the *pro rata* purchase rule to the largest extent and sell most of its shares.[159] Under this arrangement, minority shareholders become the losers because they share less of the opportunity to sell their shares through mandatory tender offer. This arrangement further frustrates the spirit of the Partial Offer Rule because the more shares the incumbent gets to sell, the fewer shares it retains and the less it concerns the target's future performance under the acquirer's control. It defeats the filter mechanism of the Partial Offer Rule.[160]

Countries adopting the Partial Offer Rule are well aware of this strategy and adopt different regulations to address it. One regulatory approach is a mandatory minimum tender offer amount. In China, for instance, acquirers are required to purchase at least 5% of shares through tender offer procedure.[161] Therefore, in the above hypothetical case, even though the acquirer is allowed to purchase 29% of the target's shares privately from the incumbent in the first place, when it comes to the tender offer procedure, the acquirer is required to offer to purchase at least 5% of the target's shares although it only wants to purchase 3%. By prescribing this mandatory minimum amount of tender offer, Chinese law indirectly forces incumbents to retain some minimum amount of shares after the acquisition.[162]

Another regulatory approach is to introduce an integrated approach that indirectly discourages the first-phase private transaction. Japan, for instance, requires acquirers to conduct all their contemplated purchase of shares, be it a single transaction or multiple transactions, within no more

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[159]For instance, if the incumbent controlling shareholder also holds 32% of the target's shares, under the normal scenario, it only gets to sell 32% of them, that is, 10.24% of the target's shares, which means that it has to hold 21.76% of the target's shares. However, under this "small-leap" arrangement, it would sell 29% of its shares to the acquirer in the first place and may sell 0.1% in the tender offer procedure (i.e. 3% * 3/(100-29)), thus holding only 2.9% of the target's shares after the acquisition. This arrangement obviously deteriorates the "skin in the game" effect of the Partial Offer Rule.

[160]Unlike the "stay-below-the-surface" circumvention, this type of circumvention is unique to the Partial Offer Rule. Under the General Offer Rule, there is no need to adopt this strategy because once the acquirer's holding exceeds the controlling threshold, it has to extend tender offer to all shareholders regardless how much it exceeds the threshold. The amount of shares obtained in the first-phase private control transaction has no bearing on the acquirer's second-phase tender offer obligation.

[161]Takeover Measure art. 25 (China).

[162]While we praise this idea in general, we are skeptical of setting the floor as 5%. In the worst scenario, the incumbent will hold no more than 5% of the target's shares after the acquisition. We are unsure if this can bring large enough "skin in the game" of the incumbent.

than 6 months, through tender offer.[163] Therefore, if an acquirer plans to acquire 29% of the target's shares from the incumbent and, within 6 months, initiates a tender offer procedure to acquire the remaining 3%, under Japanese law all of these 32% of shares must be purchased through a tender offer procedure in the first place. Any private purchase of the 29% of the target's shares will be a violation.[164] Accordingly, the "small-leap" strategy is indirectly prohibited if an acquirer fails to leave enough interval between the first-phase private acquisition and the second-phase tender offer. In response to this restriction, a cunning acquirer can still circumvent the Partial Offer Rule by leaving long enough interval between its first-phase and second-phase acquisition. However, this will delay the completion of the acquisition, which imposes more cost of capital on the acquirer. Hence, while the Japanese integrated approach may not suffice to prevent all "small-leap" strategies from being employed, at least it increases the difficulty for acquirers and incumbents to circumvent the Partial Offer Rule.

There may be a third regulatory approach that goes further. In Taiwan, the current court practice appears to inquire substantially into the real "plan" of the acquirer and oblige the acquirer to purchase all the shares it "plans" to purchase through tender offer procedure. As long as the acquirer has an acquisition plan to acquire the target's control, it does not matter if it implements this plan through a single transaction or multiple transactions or how long the interval between multiple transactions; these transactions altogether belong to an integral acquisition "plan."[165] In that sense, an acquirer cannot skip the mandatory tender offer procedure by artificially separating its acquisition plan into multiple transactions. Instead, it must acquire all these shares through a single tender offer procedure. To be fair, while the inquiry into substance may prevent more circumvention cases, it is unclear how the court should determine whether two share purchase transactions belong to an integral control transaction "plan". This could introduce considerable "grey areas" which make acquirers difficult to comply with the Partial Offer Rule. To adopt this regulatory approach thus requires a long-term development in case laws.

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[163] Financial Instruments and Exchange Act art. 27-2(1)(iv) (Japan).

[164] In contrast, if an acquirer's plan is to acquire 29% in the first place and, after 7 months, acquire the rest of 3%, because these two transactions do not occur within 6 months, it only needs to offer 3% instead of 32%.

[165] *See* Taiwan High Court Nov. 27, 2013, 99 Jin-Shang-Zhong-Su No. 61 (Taiwan).

3. "Price-cut" Strategy

The acquirer and the incumbent controlling shareholder may also frustrate the purpose of the Partial Offer Rule by cutting the tender offer price to that lower than the market price. In that case, minority shareholders will find the offer price unattractive and refuse to tender their shares, and the incumbent may then sell more its shares to the acquirer. Certainly, for this strategy to be adopted in practice, an important precondition to be met is the incumbent's consent. Normally, a rational and arms-length incumbent should be reluctant to accept a lower offer price, considering that it holds the most of the target's shares and will suffer significant loss by a low tender offer price. However, in some special occasions, for instance, if the incumbent itself is under urgent needs to cash out its shares, or if the acquirer is an interested party to the incumbent, or if both parties agree on some under-table payment,[166] the incumbent might be willing to accept a low tender offer price. Therefore, we cannot rule out the possible use of this "price-cut" strategy as well.[167]

One regulatory approach often employed by the General Offer Rule camp is setting some statutory floor limits to the tender offer price.[168] In the Partial Offer Rule camp, tender offer price limit is relatively rare but still present. China, for instance, requires the tender

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[166]Specifically when the regulator fails to capture the use of the above "small-leap" strategies, the acquirer and incumbent can arrange a private transaction with a higher acquisition price in the first place then initiate the mandatory tender offer procedure with relatively lower offer price; in that way, the higher private acquisition price can compensate for the subsequent lower tender offer price while the incumbent can still sell more its shares in the tender offer.

[167]We admit that some of these occasions may involve the breach of the incumbent controlling shareholder's fiduciary duty. However, because many countries lack a robust enforcement system as mentioned above, a breach of fiduciary duty does not mean that such behaviors will not be tolerated. Besides, sometimes it is challenging for other minority shareholders to establish the case of a breach of fiduciary duty.

[168]Price limit is quite common in countries implementing the General Offer Rule because there the tender offer takes place immediately after an acquirer purchases controlling blocks from the incumbent and, without an offer price limit, minority shareholders might feel coerced to sell their shares in the second-phase tender offer. For the introduction of the price limit in European countries, *see generally* CMS Cameron McKenna LLP, *supra* note 66.

To be sure, one should caution against generalizing the experience of the General Offer Rule camp to the Partial Offer Rule camp because both regimes are quite fundamentally different. The mandatory tender offer under the Partial Offer Rule does not take place after the control transfer is done; it is instead the process of control transfer. Rather than ensuring the undistorted mind of minority shareholders *after* the acquisition, the price limit under the Partial Offer Rule, if needed, is concerned with the undistorted mind of minority shareholders *before* the acquisition. Nevertheless, to the extent that both regimes employ a sharing vehicle to filter out inefficient transactions from efficient ones, one might ask if the Partial Offer Rule camp should introduce similar tender offer price limit.

offer price to be no less than the highest price that the acquirer paid for purchasing the target's shares within 6 months before the announcement of the tender offer.[169] Canadian Ontario similarly requires the tender offer price to be no less than the price paid by the acquirer for purchasing the target's shares within 90 days in advance of the bid.[170] This regulatory approach, however, calls for some caution because a price limit might risk distorting the price mechanism in the market and thus compromising the efficiency. Specifically for markets with more fluctuated stock price, the statutory floor limit may fail to reflect the true price of the target and therefore discourage potential control transactions.

B. *Circumvention Through Interference in Rule-making*

In their implementation, all mandatory bid rules, both the General Offer Rule and the Partial Offer Rule,[171] are imperfect. Often times regulatory or policy needs call for some exemption. However, this also creates a room for interested parties who benefit from under-regulation to maneuver the exemption events to fit their purpose.

1. Some Justified Events of Exemption

There are sound reasons to exempt some control transactions from being subject to the Partial Offer Rule. They can range from avoiding rigid application of the Partial Offer Rule to the pursuit of other conflicted policy objectives.

One major type of exemption events aims at fine-tuning the Partial Offer Rule in order to prevent its rigid application. As mentioned above, the Partial Offer Rule is designed for regulating control transactions, while the definition of control transactions can be far from perfect. For countries that define control transactions by a specified numerical threshold, they also acknowledge the possibility of over-regulation. To address that problem, rule-makers may exempt certain cases that reach the numerical threshold but in effect do not involve control transaction from being subject to the Partial Offer Rule. For example, in China, where the control threshold is defined as 30% of the target's issued shares, the events of exemption contain cases where the acquisition does not lead to the change of substantial controller.[172] They also contain

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[169]Takeover Measure art. 35 (China).

[170]Securities Act art. 93.2(1) (Ont.).

[171]For an introduction of the events of exemption in European countries, *see generally* CMS Cameron McKenna LLP, *supra* note 66.

[172]Takeover Measure art. 62(1)(i) (China).

cases where the acquirer has already held more than 50% of the target's shares before the acquisition,[173] because in that case the acquirer has already obtained the control over the target and its future purchase of shares no longer constitutes a control transaction. These events of exemption are soundly justified.

Other exemptions concern the harmonization with other policy considerations. One instance relates to the potential conflict of the Partial Offer Rule with the family laws. For instance, if the incumbent controlling shareholder dies and her heir inherits her controlling block of shares, formally speaking it also involves a transfer of control from the incumbent to the heir. There is a similar normative concern that the heir might be an inefficient controller to which the Partial Offer Rule should be applied. However, applying the Partial Offer Rule to that case will certainly deprive the heir's entitlement to the estate and defeat the integrity of inheritance laws. It is also meaningless because the incumbent is not there and the "skin in the game" built in the Partial Offer Rule has no subject to attach to. Accordingly, the balance of interest between various policy objectives should warrant the exemption of such transfer of control from the Partial Offer Rule.[174]

One can imagine that statutes and rules can hardly capture all cases of over-regulation and conflicting policy concerns. Acknowledging the incompleteness of *ex ante* rule-making, some countries adopt a rather *ex post* approach, which vests the securities regulators with blank discretion in examining whether an individual case deserves an exemption on a case-by-case basis. For instance, in China, the Chinese Securities Regulatory Commission ("CSRC") is vested with the discretion to exempt a mandatory tender offer for the purpose of "accommodating the development of and variation in the securities market and protecting the legitimate interest of investors."[175] To the extent that the regulator exercises this discretionary power in a fair and equitable manner, this delegation approach is justifiable. The problem, however, always lies in how to ensure that the regulator does not misuse such power.

2. Some Controversial Events of Exemption

In contrast with the above justifiable events of exemption, here we illustrate several exemption events in the real world that are rather

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[173]Takeover Measure art. 63(1)(iii) (China).

[174]The events of exemption under Chinese laws, for instance, contain the inheritance. Takeover Measure art. 63(1)(vi) (China).

[175]Takeover Measure arts. 62(1)(iv) & 63(1)(vii) (China).

controversial. To be fair, many of them originally bear sound rationales, but they also provide some regulatory loopholes for acquirers and incumbent controlling shareholders to circumvent the spirit of the Partial Offer Rule.

a) Market Purchase Exemption in Japan

Japan recognizes a controversial exemption named the "market purchase exemption." Under Japanese laws, the Partial Offer Rule and the mandatory tender offer procedure only apply to purchase of shares that are "conducted outside of Financial Instruments Exchange Markets."[176] Therefore, even if an acquirer plans to purchase more than one-third of the target's shares, which has exceeded the statutory threshold, it is not obliged to initiate a tender offer procedure to perform its plan if it purchases these shares in the public securities market. Only when it acquires the shares through private transaction will it be subject to the mandatory tender offer obligation. In addition to Japan, South Korea also adopts a similar market purchase exemption.[177] China and Taiwan, in contrast, do not.

The rationale behind this market purchase exemption relates to a somewhat different perception in Japan (and in South Korea) of the Partial Offer Rule. In Japan, for instance, it is argued that Japan's Partial Offer Rule is less concerned with the protection of minority shareholders than the pursuit of transparency of control transactions and the fair distribution of control premium. The market purchase exemption simply reflects this belief.[178] To the extent that acquirers conduct their acquisition plan through the public securities market, the market is able to absorb and then circulate acquisition-related information to all market participants, including the target's other non-controlling shareholders, and accord them adequate protection. To that extent, these non-controlling shareholders do not need a mandatory tender offer procedure in order to have access to the acquisition-related information; the market is able to reflect it. Moreover, because the acquisition is conducted in the public securities market, these non-controlling shareholders will have equal opportunity to sell their shares to the acquirer with equal price and terms and thereby share the control premium with the incumbent controlling shareholder. A mandatory tender offer procedure which is

[176]Financial Instruments and Exchange Act art. 27-2(1)(ii) (Japan).

[177]Financial Investment Business and Capital Markets Act art. 133.3 (S. Kor.), Enforcement Decree of the Financial Investment Services and Capital Markets Act arts. 140.1 & 140.2 (S. Kor.).

[178]Fujita, *supra* note 7, at 31-33.

both time-consuming and costly, thus can be unnecessary. To some extent, this rationale appears to aim at preventing a rigid application of the Partial Offer Rule, which could be a justified one.[179]

Despite the above sound rationales, the market purchase exemption risks creating a loophole for acquirers and incumbent controlling shareholders to circumvent the spirit of the Partial Offer Rule. On its face, acquirers and incumbents can hardly conduct their control transaction in the public securities market. After all, trade of shares in the public market is not face-to-face transaction. Rather, it takes place anonymously. When the acquirer offers to purchase the target's shares at a specific price in the public market, presumably all the target's shareholders should have equal opportunity with the incumbent to accept the offer and sell their shares. Therefore, one might expect that a control transaction conducted in the public market is not exclusive to the acquirer and incumbent, and thus other non-controlling shareholders can equally share the premium just as the case in the mandatory tender offer procedure.

In practice, however, it is possible for acquirers and incumbents to make a control transaction in the public market private. Unlike tender offer procedure, in which there is a specified tender offer period, which can last for weeks, for all shareholders to tender their shares, trade in public securities market is matched in second. Therefore, the equal opportunity owned by other non-controlling shareholders to join the control transaction, if any, is in only a second. Once that critical moment passes, this opportunity vanishes. In light of this feature of public securities market, if acquirers and incumbents do not wish other non-controlling shareholders to participate in their control transaction, they can have a private deal confirming all the price and terms beforehand, then time the moment to make their respective offer and acceptance in the public market. Through the assistance of experienced brokers and dealers, the incumbent can immediately accept the offer made by the acquirer, or vice versa, leaving no time for other non-controlling shareholders to join the deal. Through that arrangement, the market purchase exemption could become a loophole of Japan's Partial Offer Rule.[180]

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[179]For some justification for this market purchase exemption, *see* Andrews, *supra* note 2, at 546-47.

[180]To address this loophole, South Korea's narrower definition of its market purchase exemption may be of reference value. According to South Korean laws, the Partial Offer Rule only applies to control transactions conducted outside of the stock market. However, a negotiated acquisition of shares under an agreement between the seller and the buyer on the item, price and number of the shares can be considered conducted outside of the stock market. Moreover, even if the execution and clearance of the share transaction takes place in the stock

b) Share swap Exemption in Taiwan

Taiwan also has a special but controversial exemption that is related to share swap transactions. Share swap refers to a control transaction under which the acquirer issues its shares in exchange of the incumbent's controlling block of the target's shares. After the transaction completes, the incumbent will hold the acquirer's newly-issued shares, while the acquirer will hold the target's controlling block of shares. In Taiwan, while a cash control transaction is subject to the Partial Offer Rule, a share swap control transaction can be exempted.[181] Therefore, if the acquirer and the incumbent do not want to be restrained by the Partial Offer Rule, they can structure their control transaction as a share swap deal and therefore proceed it without triggering the tender offer obligation.

The rationale behind the share swap exemption is a fear of compromising the purpose of share swap. Share swap can result in a cross-shareholding relation between the acquirer and the incumbent controlling shareholder, under which not only the acquirer holds controlling block of shares of the target, but also the incumbent holds some shares of the acquirer. If an acquirer wishes to not only obtain the control over the target, but also establish a strategic alliance with the incumbent (for, for instance, taking advantage of the incumbent's connection, expertise or fund), share swap may be a good transaction structure to form this cooperative relation. However, if a share swap control transaction is subject to the Partial Offer Rule, a large portion of the new shares issued by the acquirer will flow instead to the target's non-controlling shareholders, while the incumbent may receive fewer. This might frustrate the formation of a strategic alliance between the acquirer and the incumbent. To some extent, this event of exemption aims at harmonizing the purpose of the Partial Offer Rule with other policy considerations, which could be justifiable in theory.

Nevertheless, a number of arguments may challenge the share swap exemption. First of all, not all share swap deals aim at building strategic alliances. In many cases, an acquirer engaging in share swap in fact has no plan of strategic alliance. It chooses share swap simply because it is cash-deficient: by conducting a share swap, it does not need to raise cash or incur debts to pay for the acquisition, which alleviates its

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market, the Partial Offer Rule still applies. *See* Enforcement Decree of the Financial Investment Services and Capital Markets Act art. 144 (S. Kor.).

[181] Tender Offer Regulation art. 11(2)(v) (Taiwan).

capital or liquidity pressure.[182] The strategic alliance concern does not exist in such cases. Therefore, exempting these share swap transaction from the Partial Offer Rule is simply meritless. It further discriminates against cash transaction and implicitly encourages acquirers to opt for share swap deal instead of cash deal, which will distort the acquirers' rational decisions and incur efficiency loss.

Moreover, even if an acquirer contemplates a strategic alliance, subjecting share swap transaction to the Partial Offer Rule has no practicability issue. For instance, an acquirer subject to the Partial Offer Rule, but wishing to form a strategic alliance with the incumbent, can pay other non-controlling shareholders in cash equivalent to the value of the share consideration while engaging in share swap with the incumbent controlling shareholder.[183] Therefore, the share swap exemption implemented in Taiwan requires more contemplation.

c) State-owned Enterprise Exemption in China

China has a different controversial exemption that favors Chinese state-owned enterprises ("SOEs"). In China, if a free transfer, changes or merger of state-owned assets approved by the government or the state-owned asset management authority causes an investor to hold more than 30% of the target's issued shares, the parties may file for exemption from the CSRC.[184] Besides, as mentioned above, the CSRC also has the discretion to exempt an individual case. Coupled with the CSRC's long friendly attitude toward Chinese SOEs, control transactions between SOEs are often exempted, while those between private enterprises are subject to stricter mandatory tender offer rule.[185] Non-controlling shareholders of listed Chinese SOEs, therefore, are subject to less protection.

The rationale behind the SOEs exemption is to facilitate the restructuring of Chinese SOEs as well as to prevent the reduction of state-owned assets. Chinese SOEs still play an extremely influential role in Chinese economy,[186] which is a crucial vehicle for Chinese party state

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[182]To be sure, share swap still incurs some side effects. Because the acquirer needs to issue new shares to pay for the acquisition, it might risk diluting its shareholders' shareholding and introducing the incumbent controlling shareholder to become its blockholder.

[183]Andrews, for instance, argued that share swap should not serve an excuse for exemption. For his detailed analysis, *see* Andrews, *supra* note 2, at 549-50.

[184]Takeover Measure art. 63(1)(i) (China).

[185]Weng, *supra* note 7, at 200-01, 209-10.

[186]It has been reported that, even after 35 years of economic reforms since 1978, it is estimated that the share of GDP owned and controlled by the state and SOEs remain approximately 50% as of the end of 2011. Andrew Szamosszegi & Cole Kyle, *An Analysis of*

to maneuver economic development and exercise political control of the society.[187] Notwithstanding the continuous appeal for SOEs reform, Chinese party state is by far reluctant to relinquish its control over SOEs.[188] At the meantime, it becomes increasingly needed for China to restructure its SOEs, in particular to consolidate the SOEs in similar businesses, to enhance overall operational efficiency.[189] To respond to that demand, control transaction is a way to restructure under-performing SOEs. However, the Chinese party state definitely does not want other non-controlling shareholders to involve in the control transfer and complicate the restructuring process. By virtue of the SOEs exemption, SOEs and state-owned asset management authorities may find a way out from the Partial Offer Rule.

Moreover, control transactions between SOEs are under the maneuver of the Chinese party state's "visible hand" as opposed to the market's invisible hand. Therefore, in any event, the target is transferred to a state controller, which, under Chinese legal regimes, is presumed to be well-disciplined and thus benevolent. If that is the case, the need to apply the Partial Offer Rule to introduce market discipline for promoting efficient transaction is minimal. Hence, in the Chinese context, the SOEs exemption might be justifiable.

However, the justification for SOEs exemption depends largely on the benevolence of the Chinese party state. To some degree, the SOEs exemption represents an epitome of the Chinese-style corporate governance, under which the party state heavily intervenes in corporate decisions.[190] In many circumstances, the judgment of the Chinese party state replaces private ordering in allocating resources of the Chinese economy. Like here, whether a control transaction is efficiency-increasing and thus allowed is determined by the government, not by

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State-owned Enterprise and State Capitalism in China, U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION, (October 26, 2011), at 1.

[187]For an introduction to the role of Chinese SOEs in Chinese society and how the party state exercises its power, *see generally* Li-Wen Lin, *State Ownership and Corporate Governance in China: An Executive Career Approach*, 2013 COL. BUS. L. REV. 743, 744-47, 750-53 (2013); Li-Wen Lin & Curtis J. Milhaupt, *We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 ST. L. REV. 697, 699-700, 734-36 (2013).

[188]*See* Chinese State Council, "*Guiding Opinions regarding Deepening the Reforms of State-owned Enterprises*" CHINESE GOVERNMENT NETWORK (Aug. 24, 2015), http://www.gov.cn/zhengce/2015-09/13/content_2930440.htm.

[189]*Id.*

[190]And this Chinese-style corporate governance is in turn an epitome of the Chinese-style state capitalism. For some introduction to this Chinese-style state capitalism, *see, e.g.*, RONALD COASE & NING WANG, HOW CHINA BECAME CAPITALIST (2013); YIFU LIN, DEMYSTIFYING THE CHINESE ECONOMY (2012); YASHENG HUANG, CAPITALISM WITH CHINESE CHARACTERISTICS: ENTREPRENEURSHIP AND THE STATE (2008).

related market players. To the extent that the Chinese party state can correctly determine which governmental entity or state-asset management authority is a more efficient controller of a given SOE, this state-dominated model may do less harm than what market capitalists predict.

Nevertheless, the core question is how to ensure that the party state's judgment is superior to the market's ordering. Perhaps the party state has superior knowledge of the needs of Chinese economy, politics, and society, which enables it to entrust a given SOE to an appropriate agency. However, as more non-economic factors penetrate in the decision-making process, one can hardly tell if the party state's decision is for the public interest of the society or merely for the private interest of the party. As the path of SOEs reforms in China becomes increasingly marketized, at some point China might want to revisit the role of the party state vis-à-vis the market in corporate governance, including in control transaction regime and the SOEs exemption here.

C. *Summary*

In sum, the Partial Offer Rule in the real world is not as rosy as that in theory. Market players could invent many ways to circumvent the rule. A country's political economy might further enhance the circumvention to a rule-making level. This again proves that the devil always hides in the details.

V. CONCLUSION

Through this Article, we contribute to current comparative studies of control transaction regimes by exploring the Partial Offer Rule, a middle way of control transaction regimes that is common in East Asian countries, including Japan, South Korea, China and Taiwan. By factoring in the cost of fund to the traditional economic analysis, we demonstrate that the Partial Offer Rule, compared with the General Offer Rule as adopted in EU countries, is more efficient and representative of the mandatory bid camp. We also compare the filter function of the three regimes and argue that the incumbent controlling shareholder filter as employed by the Partial Offer Rule is more effective. In sum, we illustrate from a theoretical perspective the merits of the Partial Offer Rule.

That being said, at this moment we hesitate to claim the superiority of the Partial Offer Rule. We wish to highlight a fundamental assumption of our analyses throughout this Article, that is, the presence of an incumbent controlling shareholder. According to our reasoning,

the theoretical charm of the Partial Offer Rule consists of the "skin in the game" on the part of the incumbent controlling shareholder. This, however, requires the presence of an incumbent. If the target's shareholding structure is dispersed and lacks an incumbent, the merits of the Partial Offer Rule we claim in this Article will be limited. In that case, the Partial Offer Rule does nothing more than provide an equal opportunity for all shareholders to share the target's control premium, but now we find little justification to explain the efficiency functionality of allowing a statutory intervention to have all shareholders share the control premium. Following that line, the desirability of the Partial Offer Rule might be less solid where a company's shareholding structure is mostly dispersed, which is common in the United States and the United Kingdom. From this ownership structure perspective, perhaps one may explain why these two countries do not adopt the Partial Offer Rule but each becomes the leader of the Market Rule camp and the General Offer Rule camp.[191] In sum, the one-size-cannot-fit-all problem still exists.[192]

Finally, the political economy of a country also matters.[193] For instance, it was raised that the General Offer Rule does not necessarily fit the functionality needs of many EU countries, but these countries agreed to the introduction of the General Offer Rule into the Takeover Directive due to their political economy.[194] Similar issues also exist in the Partial Offer Rule camp. One may observe this from those controversial events of exemption as mentioned above. These compromises could be the products of a given country's political economy. For instance, the SOEs exemption in China as mentioned above might result from the political influence of Chinese SOEs' managers and the party state's economic

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[191]Ventoruzzo, for instance, argued that for widespread ownership structure, mandatory bid rule is more about preventing the birth of a large block-holder who may weaken the potential discipline of the market that is uneasy to reverse, while for concentrated ownership structure the mandatory bid rule helps the controlling shareholder to fend off an undesired suitor. Ventoruzzo, *supra* note 2, at 139-40, 168-72. In contrast, for arguments suggesting that ownership structure plays little rule in the formulation of particular acquisition of control rules, *see* Magnuson, *supra* note 2, at 234-35.

[192]Another aspect that may complicate our analysis relates to the fact that some controlling shareholders may have levered control through, for example, dual-class stock. Researches have noted the potential agency problem derived from the separation of a shareholder's voting right and cash flow right. *See generally* Lucian Aye Bebchuk et al., *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control From Cash-Flow Rights, in* CONCENTRATED CORPORATE OWNERSHIP 445 (Randall K. Morck ed., 2000). For some discussion of how the levered control complicate the control transaction rules, *see* Enriques et al., *supra* note 9, at 101-02.

[193]Magnuson, for instance, argue that the difference in control transaction regime between the United States and EU countries is due to the difference in law formulation process and institutional competency: the rule-maker in the United States is the court while that in EU is the political actors. *See* Magnuson, *supra* note 2, at 207, 239.

[194]*See* Ventoruzzo, *supra* note 2, at 137, 168.

planners. The market purchase exemption in Japan and the share swap exemption in Taiwan might also result from the political influence of related interest groups in these countries, such as those comprised of incumbent controlling shareholders. The political factors behind the Partial Offer Rule camp are worthy of further exploration. In conclusion, we believe the Partial Offer Rule deserves more attention from comparative studies.

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