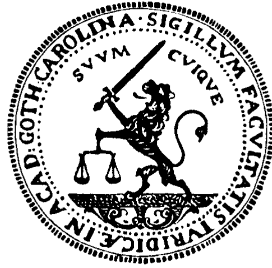

Faculty of Law
University of Lund

HOSTILE TENDER OFFERS AND ANTI-TAKEOVER DEFENSES

-A Comparative Analysis based on a Law and Finance Approach

Author: Henrik Johannesson

Supervisor: Professor Lars Gorton

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1. Hostile Tender Offers and Anti-takeover Defenses

1.1 Introduction

Are there more hostile takeovers in Europe's future? After a year that saw Banque National de Paris take over Paribas, Olivetti gobble up Telecom Italia, and Vodafone AirTouch prevail over the reluctant Mannesmann, there seems no stopping European raiders.

The current European takeover boom has its roots in the so called "merger mania" which struck the U.S in the early 1980's. Between 1983 and 1986 just about 12 200 American companies and corporate divisions changed hands in transactions worth at least 50 billion dollars. Since then the trend has continued reaching a new record year in 1999 where merger transactions only in the U.S reached a value of more than 1000 billion dollars. Also in Europe the merger trend has culminated to a record high, with a total announced value of 1,739 billion dollars in 1999. The woldwide M&A transactions up to date have an announced volume of 3,693 billion dollars compared to 4,481 billion dollars in 1999.[1]

Sweden, also playing on the European arena with the ambition to become a major global player, is similarly undergoing an unprecedented wave of mergers. The Swedish merger escalation began ten years ago when Swedish-based Asea, an electrical engineering group, merged with its Swiss counterpart Brown Boveri to form ABB. The ABB model has led to several similar transactions, where a number of Swedish corporations have merged with foreign competitors or been bought out by them. A few examples include: Forest product giant Stora and Finland's Enso, the government-dominated bank Nordbanken and Finland's Merita, the chemical group Kema Nobel and Dutch-based Akzo, the packaging company PLM and Britain's Rexam, the computer services company Enator and Finland's Tieto, the freight forwarding company BTL with Germany's Stinnes, Ford Motor Company's acquisition of Volvo Cars as well as Volvo AB's recent purchase of French RVI/Mack. As one can conclude from these examples the merger mania has effected most industries, creating a great reorganization on the Swedish market, with several Swedish companies now acting on a global basis.

However, among all the mergers that where announced during the record year of 1999, only eight successful hostile bids against Continental targets were revealed, where the enormous price tags on takeovers such as Mannesmann AG ($187 billion) and Telecom Italia SpA ($34 billion) conceal how rare such hostile deals are. Has the hostile bid activity, which peaked in the late 80's and fell to unusual lows in the early 90's, run its course due to a tide of

[1] Thomson Financial Securities Data, BRC, J.P Morgan London

legislation aimed at correcting the abuses and societal ills generated by acquisitions and as a result of the wider use and development of takeover defense mechanisms?

Hostile M&A in Europe dates back to the early 1960's in the UK, when the city of London still resembled a financier's club (even the Stock Exchange was a mutual society) and hostile takeovers where rather frowned upon. Morgan Stanley is often said to have promoted the first US hostile offer in 1973 when advising International Nickel Co for ESB Inc, however the first UK hostile takeover predated this in the early 1960's when Reynold's Inc, advised by S.G Warburg, made a trend setting hostile offer for British Aluminium Ltd.[2]

To every action there is a reaction. As hostile takeovers became standard in the UK, practitioners developed increasingly sophisticated expertise, both in structuring, implementing, and in defending against hostile takeovers. Just as the hostile bid itself, the dexterity to defend corporate merger targets developed into something shrewd, aggressive and complex, where the goal is, whilst still acting within the legal framework, to thwart the bidder in order to maintain the independence of the target. The defense arsenal that unwelcome bidders confront on the market today is a thus matrix of complex and constantly evolving legal and financial weaponry that has been developed over time.

Important to note, however, is that even if defensive strategies have for several years been used in takeover battles; they remain by all means controversial. Proponents of defensive strategies maintain that they increase the ability of the target management to extract a higher price for target shares. Opponents of such strategies, on the other hand, argue that resistance reduces the probability of takeover, and, therefore target shareholders are worse off overall. Closely linked to these competing standpoints are the aspects of corporate governance and the agent theory. Due to the fact that ownership and control are separated in listed companies there will always be an intense conflict of interests between shareholders and management, a conflict that has a large impact on the legality and applicability of defense measures against hostile bids.

From this historical background and perspective, I anticipate a M&A development in Europe that could overtake historical US and UK M&A activity. The value of corporate Europe is vast, and it needs to expand to survive in increasingly global markets. It is also overdue for consolidation, having been protected from takeovers for decades by legal and a cultural

[2] Hopt, K., Wymeersch, E., (1992) *"European Takeovers – Law and Practice"*, p.83

tradition which has not traditionally placed maximizing shareholder value over all other considerations.

The increasing M&A activity should also result in an increasing number of hostile bids, thus creating a greater demand for anti-takeover mechanisms and strategies. The world's leading international investment banks and law firms are hoping that this will prove to be true – and have enlarged their M&A groups in Europe substantially in recent years. The consequence of an escalated hostile M&A activity should intensify the debate concerning the anti-takeover legislation and regulation. It is due to these reasons that I find it interesting and rewarding to base my thesis on this topicality.

1.2 Query

During the past decade corporate Europe, including Scandinavia and Sweden, has witnessed an increasing boom of corporate takeovers, a so called "merger mania". Significant for this recent wave of takeovers, to differ it from the one in the 1950's and 1960's, is that corporations have started to make mergers and acquisitions without negotiating with targets prior to the initial bid and regardless of consent from the targets board of directors. Thereof the term "hostile takeover".

The phenomenon hostile takeover has been widely debated in theory as well as in practice, where many have asked themselves the question "who gains from such a method of acquisition"? Some wish to prohibit hostile takeovers as such as the method can be prejudicial to company's long-term competitiveness as well as to the macroeconomic structure as a whole. On the other hand, those who differ, mean that hostile takeovers do not necessarily have negative consequence as they tend to maximize shareholder value.

Closely linked to the discussion above is the question if a board should and has the right to defend itself and its company against a hostile takeover. Should the board follow its own opinion about the corporation's long-term profit potential or should it aim to maximize immediate shareholder wealth?

Regardless of opinion, it is a fact that, within a takeover context, the company faces one of the most intense conflicts of interests represented in a corporation: a conflict between the directors and their interest to perpetuate their presence in their office and the shareholders and their interest to maximize their wealth. In most cases the directors of a target company face the possibility of being replaced right after the completion of a change in ownership and loosing their offices together with the chance to complete their long-term strategy for the

corporation. As a consequence there is a risk that a management does not act properly as an agent for its shareholders by defending a bid, but instead acts primarily to preserve its own interests.

Over time a wide variety of defense mechanisms and strategies have been developed in the U.S and the U.K against hostile takeovers, all to safeguard the existence of the own corporation. Yet when it comes to takeover legislation, regulation and practice, large differences can be found between the US, the UK and Sweden repsectivly.

1.3 Aim

Firstly, my aim is to discuss the existence and development of friendly and hostile takeovers as well as possible motives behind such methods of acquisition. A historical preview and a discussion concerning commonly used tender offer techniques will be a natural ingredient.

Further, my ambition is to analyze, from a comparative point of view, contemporary US, UK and Swedish takeover legislation, regulation and control. The aim of the analysis is twofold: Firstly I aim to give the reader an understanding of the differences between the three country’s takeover legislature. Secondly, the analysis is meant to be an introduction to my discussion concerning anti-takeover defenses that may be used in the US, the UK and Sweden respectively. In the discussion a description of various defense tactics will be accounted for, where each defense will be followed by a legal comment analyzing the regulatory implications that each tactic may have in the above mentioned three countries.

The conflict of interests between shareholders and management mentioned in the query will permeate the description, discussion and analysis of common takeover defense mechanisms.

1.4 Method

The underlying method that I have used when writing this thesis has been based on a law and finance approach. I have aimed at studying a well-balanced sample of literature as to converge the subject from a legal- as well as a financial point of view.

The sources that I have used have been of both legal and business orientated, where I have aimed at comparing theory with what is applied in practice. The choice of literature has been based on references made by other authors on the subject as well as results achieved through extensive research in various databases. The interviews have been made in person, where contacts have been made with people who have found interest in my subject. Even in my

choice of interviewed people I have tried to reach a reasonable balance between law and finance, hence the interviews have been with lawyers as well as with finance related managers. However, as the subject is of a cross-boarder nature, the discussions have not strictly fallen within the scope of each person's expertise, where I have tried to understand the lawyer's view upon finance and vice-versa.

The analysis of defense mechanisms against hostile takeovers has been done from a target management point of view, where I have aimed at clarifying the legal aspects involved in such action. With respect to the fact that the agency theory is a stepping stone throughout the discussion, it has also been natural to analyze the theories behind corporate governance.

Conclusively, as hostile tender offers and anti-takeover defenses are primarily achieved through the means of securities markets, it has been natural to analyze the financial theories in relation to the regulatory framework that set up the barriers for the means of transaction.

2. About corporate takeovers

2.1 Definitions

The topic corporate takeover is a theme that has lately been widely discussed in media, in financial and legal literature, and not the least in many boardrooms. However, the phenomenon is nothing new, and before engaging in an analysis of corporate takeovers and before giving the historical background to the phenomenon, I find it in place first to define my interpretation of the term "corporate takeover".

A corporate takeover is characterized by the purchase of all, or part of all, shares or assets in a corporation by an already existing entity and when a substantial part of the corporate control is transferred from the target company and its owners to the buyer.[3]

Thus, a corporate takeover differs from an investment in the sense that *"/.../a merger or acquisition is an exchange of existing assets (a purchaser pays cash for the plant, equipment, personnel, and goodwill of an existing firm), whereas investment flows involve the creation of new plant and equipment"*.[4]

2.2 Historical Background

"Merger activity has always ebbed and flowed, and the characteristics of each new wave are different in significant ways."[5]

A first major merger wave can be noted in the US during the late 1890's, a wave that lasted until 1904. The period, which reached its all time high in 1899, was characterized by a steady and rapid economic expansion. Corporations merged horizontally, creating high concentrations mainly in heavy manufacturing industries. Several large developments within the US infrastructure were achieved during this period, where the completion of the transcontinental railway as well as the introduction of electricity, serve as two examples. The motives behind the urge to merge have been described as "merging for monopoly", creating large corporations and economies of scale. In fact, the combinations achieved between 1887-1904 included approximately 15 percent of the total US manufacturing workforce and plants, and more than 80 percent of these mergers occurred between 1897 and 1904. The boom came to an end in 1904, partly because of an economic recession, yet also due to a US Supreme Court decision prohibiting "every combination in the form of trust or otherwise".[6] Worthwhile

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[3] Interview with Carl Bennet 000830

[4] Auerbach, Alan., (1988), *"Mergers and Acquisitions"*, p.40

[5] Boesky, Ivan F., (1985), *"Merger Mania"*, p.1

[6] Weston, Fred J., Chung, Kwang S., Hoag, Susan E., (1990), *"Mergers, Restructuring, And Corporate Control"*, p.8f

noting here is the fact that already at this early stage the legislature and its decision-makers identified the need for merger legislation and regulation, partly putting and end to the first US merger boom. Today the legislation has developed in such a way that it does not only see to antitrust matters, but also to corporate-policy and good practice on the stock-exchanges.

The second large merger wave came in the 1920's, also as an effect of an economic upswing, yet this time it was mainly the banking, food, chemicals and mining industries that experienced rapid growth. These groups accounted for 60% of the period's mergers, where "merging for oligopoly" rather than "merging for monopoly" was commonplace. Further, in contrast to the turn of the century, companies, such as IBM, General Foods and Allied Chemicals, were now involved in vertical integration, where product extension and differentiation were major motivational factors to corporate takeovers. Rather than legislature, it was the great depression that put an end to the merger boom of the 1920's.[7]

As for the UK before the great depression, the market was strongly affected by a laissez-faire attitude, where imperfect competition, governmental involvement and takeover activity was rare. It was only industries where the market seemed to react slowly and where government intervention was necessary, such as the mining industry, which faced merger activity.[8]

Except for a short merger movement after the Second World War, it was not until the 1960's, the "go-go years", that the US and the UK experienced another great wave of merger activity. In the US one speaks of a conglomerate merger movement, whilst in the UK it was more of a horizontal movement emphasizing the importance of economies of scale. The conglomerate merger movement in the US faced its peak 1967-68, when vertical and horizontal mergers only accounted for 17 percent of the total merger activity. The acquirers as well as the targets were small and medium sized companies who adopted diversification strategies in order to enter business's that did not coincide with their own. Conglomerates diversified defensively through mergers in order to protect themselves from fluctuating markets, unstable sales and profits as well as it was an effective strategy in order to overcome new technological know-how.[9] However, in the UK during the 1960's, the main reason for corporate takeovers was to protect companies from increasingly competitive US as well as European corporations.[10]

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[7] Weston, Fred J., Chung, Kwang S., Hoag, Susan E., (1990), *"Mergers, Restructuring, And Corporate Control"*, p.9
[8] Cooke, Terence E., (1988), *"Mergers and Acquisitions"*, p.7f
[9] Weston, Fred J., Chung, Kwang S., Hoag, Susan E., (1990), *"Mergers, Restructuring, And Corporate Control"*, p.12f
[10] Cooke, Terence E., (1988), *"Mergers and Acquisitions"*, p.10f

Both in the UK and the US the early 1970’s meant a steep decline in M&A activity, yet due to low stock prices and relentless inflation the late 70’s turned out to be an active merger period. Corporations found it cheaper to grow through acquisitions rather than to grow organically. It was mainly the banking and financial services industry that experienced product-extension, market-extension, and pure conglomerate acquisitions, primarily as a result of a deregulation of the industry. [11]

Although a long history of mergers and acquisitions, the merger mania that we speak of today in Europe has its real roots from the very intense M&A movement that began in the US after the deep recession in 1981-1982. The rush in the US between 1983-1986, when 12 200 companies changed ownership, i.e. merger mania, was primarily fuelled by the introduction of the so called “junk bonds”, which enabled companies with a low credit rating to borrow much more than their credit rating would normally allow.[12] During this period, rather than reaching into new areas of business, corporations were intent on sticking to their core business’, conglomerization was no longer fashionable and companies bought corporations in their own or closely related fields. Beside the above mentioned junk bond, leveraged buy-outs (LBO), stock and debentures, rather than cash, were now effective and popular ways of acquiring and paying for companies and divestitures.

In 1986-1989 also the UK experienced its probably most significant merger boom ever, when only in 1986 695 British companies changed hands. This intensive merger activity in the UK is referred to as the “mega-merger” period, which closely followed the merger mania in the US. The incidence of so called “mega-mergers” pushed up the average value of an acquisition from 3.1 million pounds in 1980 to a high of 25.9 million pounds in 1989.[13] Interesting in this context is the fact that potential acquirers in many of the takeover transactions in 1986-89 no longer restricted the targets to companies smaller than themselves. Thus, a company’s size was no longer deterrent against a takeover bid. It may also be worth mentioning that the British stock market had to face a problem comparable to the appearance of raiders in the US. However, while raiders in the US made use of favorable financial conditions, which had been introduced by the above mentioned junk bonds, the financial market of the UK invented a system of so called “success geared fees” for merchant bankers. This encouraged small companies to mount larger bids by reducing the cost of eventual failure. The introduction of “success-geared fees” had certainly major implications for potential bidders. Companies who could negotiate a reduced commission with their creditors in the event of an unsuccessful bid

[11] Auerbach, Alan J., (1988), *“Mergers and Acquisitions”*, p.28ff
[12] Time Magazine, *“Come Together, Right Now”*, August 15, 1994
[13] Acquisitions Monthly, Annual Review of 1989

were more willing to pursue larger companies. If the bid value were to be too great, the penalty for failure to gain control would be reduced.

During the last decade the merger mania has seemed to continue in a steady course. Each year between 1994 and 2000 have turned out to be record-breaking years. In resemblance to the turn of the 20th century, today's markets are experiencing tight constellations within each industry. Corporations are merging for structure, where big is beautiful. During most of the 1990's it was all about downsizing, rationalization, and stinginess, yet today there is not much left to cut back on. In order to protect their market positions and in order to survive, companies are today forced to look for friends. Either grow big and dominant or become a niche player, however there is no in between. This merger mania has reached all industries, where large cash surplus and excess venture capital has boosted the process. Further, high market quotations have made it possible for corporations to use their own stock when paying for their acquisitions. Interesting to note, however, is that today's merger activity cannot be compared to the one of the eighties. The latter wave was vicious, aggressive and with a killer instinct, where the main goal was to acquire through loaned money, spin-off and make money on divestitures. Today's activity is aimed at survival.[14]

Conclusively, it is clear that today's intense debate concerning the merger phenomenon is nothing unique. All the way through the 21st century several great merger booms have ebbed and flowed, some greater some smaller. Efforts have been made trying to explain the causes and consequences of these merger waves, however, theories explaining one wave have failed to explain another. Whatever the reasons, the near future will probably continue to experience record breaking years. Whatever direct extrapolation from US and UK experience will prove to be unduly simplistic remains to be seen. EU cross-boarder imperatives may call for a wider range of skills and more complex structures than the simpler offer for one company by another. Cooperative mergers may therefore represent a higher proportion of the major deals, and advisers with multi-jurisdictional capabilities will be more successful than those who understand the practice of only one or two jurisdictions.

2.3 Motives for corporate takeovers

2.3.1 Introduction

As history has shown, the ebbs and flows of merger activity have emerged from various kinds of financial and political climates, where the motives behind corporate takeovers have been affected by the current milieu. I do, however, dare to infer that there is one common motive

[14] Ericsson, Bengt., Veckans Affärer 19980316

behind all mergers and acquisitions, irrespective of climate, namely that all corporate takeovers made by rational acquirer's aim at creating financial profits.

Yet, in order for an acquisition to be feasible, there must be a difference between the buyer's and the seller's valuation of the target company, i.e. a valuation gap. The reasons why a potential buyer values the target differently from the seller may be many, but it is a fundamental criterion that has to be fulfilled. The motives that are made known when a takeover is made public may not always be the same motives that initially caused a takeover. Further, *"if the determination to merge is internally generated rather than the result of external attractions, then there may be little pattern to the types of firms that are acquired"*.[15]

Thus, depending on how a potential bidder wishes to value a potential target, a valuation gap may be created, generating a wide fauna of motives behind corporate takeovers. Based on literature and interviews I have decided to divide some of these current motives into three main categories; synergetic motives, value-related motives as well as managerial related motives.

2.3.2 Synergy, Operation, Value and Management

I. SYNERGETIC MOTIVES

a) **Short-term financial motives**

- ***Tax reasons***. Acquired corporations may have idle tax deductibles that the acquirer wishes to take fully advantage of.

- ***Improved liquidity and capital utilization ratios***. Cash flow netting pools and inter-bank functions within affiliated companies require a certain corporate dignity in order to be used effectively.

- ***Earnings per ratio and P/E multiples***. By knowing how these multiples are constructed the market can be lured. During the conglomerate era in the US during the 1950's and 1960's the market was lured by a fictively disclosed growth. After time, when this growth was noticed, many possibilities for effective corporate takeovers disappeared.

b) **Long-term financial motives**

[15] Davidson, K. M., (1985), *"Megamergers"*, p.148

- ***Increased debt capacity***. Acquired corporations may have unused debt capacities which an acquirer wishes to exploit.

- ***Reduced interest- and bankruptcy costs***. The direct costs related to interest and bankruptcy measured as a ratio of the corporation's size fall when the size of the company increases.

- ***Stabilizing revenues***. Through the acquisition of a company with an income stream which is negatively correlated to the own company's, a more stable revenue's stream can be achieved.

- ***National regulations***. In Sweden for example, for tax purposes, it can be more advantageous to acquire other companies than to distribute dividends to the shareholders.

c) **Operational motives**

- ***Expansion***. It is usually easier to expand through acquisitions than to grow organically.

- ***Economies of scale***. The price per unit or price per process is reduced when the absolute volume is increased.

- ***Decreased risk***. A successful diversification makes a corporation less vulnerable to cyclic changes of the market.

- ***Overripe industry***. The company may lack investment possibilities in its own industrial sector, where an acquisition can help it to grow out of an overripe industry.

- ***Limiting competition***. A Corporation may acquire a target in order to create a foothold on the market and restrain competitors from expanding within the industry.

- ***Acquisition of knowledge***. A target may have specific knowledge that only can be attained through an acquisition. Patent and know-how serve as two examples.

II. VALUE RELATED MOTIVES

- ***Lack of information***. When there is a wide gap between information and expectations on the market there will be an increased probability that a potential buyer is more optimistic about a target's future than its current owners.

- ***Insider information***. A market player may have access to information that makes him willing to acquire a company to a higher than market price.

- ***Badly managed companies.*** A company may be undervalued due to bad a management which has not been able to maximize the company's value. Through an acquisition and a replacement of management a higher corporate value can be achieved.

- ***Entity spin-off***. A thorough valuation of a target company may show that the company's different entities are worth more separately than when valued together. A purchaser may then create a profit by disjointing and selling off the different entities.

III. MANAGERIAL MOTIVES

- ***Prestige***. *"Managers read the newspaper and see all these big deals going and they want to get in on the action and buy somebody"*.[16]

- ***Compensation***. Management's salaries and benefits are often strongly correlated to the size and dignity of the company. Instead of maximizing value, a management may only see to the size of the corporation and their own position within. The more power the management possesses, the more difficult it is to question its levels of compensation.

- ***Retirement positions***. Through the acquisition of companies with international structures, such as subsidiaries placed abroad, retirement positions can be created.

2.3.3 Conclusion

As one can see, there are several motives behind a corporate takeover, where various factors combined create reasons for corporations to merge. Mergers have shown to provide practical alternatives for successful corporations that need to place their excess profits. Corporate takeovers solve the problems posed by other uses of profits, such as reinvesting in the existing enterprise, distributing the profits to shareholders, starting new businesses, investing in securities and giving profits to employees. Further, the decision to acquire a firm serves another important function; it is a decision capable of rational defense, i.e. matched with the creation of a new business, a merger is often a much less risky venture for corporate executives to enter.

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[16] Fortune, July 23 1984

Takeovers, therefore, provide a lucrative solution for the profitable enterprise holding excess profits. By combining the interests of management and shareholders in the hunt for subsequent profits, takeovers can promote corporate development and accommodate as much as a firm has at its disposition. Takeovers have become on our day a logical, although not inevitable, result of corporate success.

3. Hostile Takeovers

3.1 Introduction

For several reasons I find it essential and necessary to make a distinction between "friendly" and "hostile" corporate takeovers. Not only does a distinction play an important role when I later on discuss takeover defense tactics, it also meaningful from a legal as well as commercial perspective. It is essential to identify the mood and legal nature of a merger or acquisition, as hostility can have a great impact on the motives, tactics and legal framework behind an unwelcome and unsolicited bid. Thus, keeping the more general discussion about corporate takeovers from the above section in mind, I am in the coming section going to, more thoroughly, account for hostile takeovers *per se*.

3.2 Defining "Hostile Takeover"

Among the legal as well as business related literature that I have studied, I have surprisingly enough come across very few definitions to the term "hostile takeover". At the same time as authors seem to take for granted that people in general know the meaning of a hostile takeover, I get the impression that some authors do not wish/dare to define the term as the phenomenon is quite complex and difficult to identify. Should for example, a takeover, that gradually changes from hostile to friendly be considered as a friendly or a hostile takeover?

Shivdasani (1993) has defined a takeover as hostile *"/.../if the initial bid was rejected or not acknowledged by the board. Active management resistance in the form of anti-takeover measures/.../is also taken as evidence of the bidders hostility"*.[17] Auerbach (1988), quite similarly, defines an acquisition hostile if *"/.../it was not negotiated prior to the initial bid, was not accepted by the board from the start, or was contested by the target management in any way"*.[18] A third author, Christensen (1991) believes that the term hostile is misleading. *"Except for the lack of cooperation between the acquirer and target-management, this type of corporate acquisition conceptually carries with it no hostile elements"*.[19] Rather than using the term hostile, Christensen therefore instead refers to the term "contested takeover", however, I do not wish to make such a distinction in my thesis.

The reason for the difficulty to define the phenomenon hostile takeover is partly due to the fact that the aim and point of views of the owners, the management and the board of directors are not always aligned. One entity may interpret a bid as hostile while another does not. To

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[17] Shivdasani, A., (1993), *"Board composition, ownership structure, and hostile takeovers"*, Journal of Accounting and Economics No. 16, 1993
[18] Auerbach, Alan, J., (1988), *"Mergers and Acquisitions"*
[19] Christensen, Jan-Schans., (1991), *"Contested Takeovers in Danish Law"*, p.21

what extent should a board or management be against a bid in order for it to be considered as hostile? What if 10% of the board is against the bid? Or 25%? Or 49%? To what extent should the standpoints of staff and employees be taken into account?

It is obvious that there are many parties and groups of interest involved in a hostile situation, yet it is important to remember that it is the management, led by the CEO which, through the authority of the board, is responsible for the continuous day to day operation of the corporation. Therefore I will in my coming discussion not make a distinction between the board of directors and the management, however, such a distinction will be necessary in later descriptions and analysis' concerning the legal implications of existing defense mechanisms. Further I do not see to the exact resistance of a bid, instead I presuppose that board and management is either unanimously in favor or against a bid.

Finally, with the above discussion in mind, I define a hostile takeover as *an acquisition of a company's shares directly from the target's shareholders when the acquisition has not been negotiated and is officially contested by the management and/or by a majority of the shareholders*. A friendly takeover, on the other hand, is when the management and/or majority shareholders do not contest such an acquisition. Thus, the above definition in italic is my interpretation of a hostile takeover and will act as a keystone throughout my thesis.

3.3 Historical background

Hostile takeovers as a phenomenon, has its origin in the American 1970's, and, especially during the past three decades, the takeover method *per se* has often been associated with the US. However, worthwhile mentioning, is that the first real wave of hostile activity has its origin in the UK, where the 1950's experienced a great boom of this type of transactions.[20] During this period acquisitions through bidding contests became quite common. The Company Act of 1948 made it easier to replace boards of directors, earlier a very complicated legal process. The Act opened the gate for hostile takeovers, giving way to the first contested bid in 1959.[21]

Up until 35 years ago, the proxy fight, rather than bidding contests, was the most common procedure for purchasing a company in the US. However, during the later part of the 1960's, friendly as well as hostile takeovers became more respected and common,

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[20] Christensen, Jan Schans., (1991), *"Contested Takeovers In Danish Law"*, p.43
[21] Roberts, J., (1987), *"Megalomania, Managers and Mergers"*, p.51

eventually replacing proxy fights as a method for gaining corporate control. The bidding contest was quicker than the proxy fight, and it was very seldom that the latter turned out to be a successful strategy.[22] As a result, the 1970's meant a dramatic increase in cash bids at the same time as inflation became one of the most dominant economic factors. A significant downswing on the stock markets resulted in that the market no longer adequately reflected the cost of replacing fixed assets. Market values often fell below break-up values, and with deflated stock prices, a takeover boom was inevitable. Cash premiums offered sometimes exceeded market prices by 50-100 percent, which, in combination with the introduction of so-called "two-tier tender offers" effectively forced shareholders to sell. Notable is further that cash bids were in no way regulated in the US before the introduction of the Williams Act in 1968, clearly contributing to the upswing of hostile takeovers as a method of corporate acquisition.[23]

In circumstances like the above mentioned, it became natural to pay cash. Corporations did not wish to use their undervalued securities when merging, at the same time as it was, during a period of high inflation, beneficial to finance acquisitions with borrowed money as repayments were made in a deflated currency.

It was in July 1974 that the first major North American hostile takeover was completed, namely when International Nickel Company acquired ESB Inc. However, important to note is that it was not until 1982, when US based Bendix acquired and slaughtered Martin-Marietta, that the merger climate really came to a change, and hostile takeovers became even more than accepted.[24] Closely following this deal came one of the largest takeovers in the Wall Street history, namely the hostile acquisition of RJR Nabisco in 1988.

The Swedish market has experienced relatively few hostile bids, where the number of successfully completed hostile takeovers, are even more scarce. One suggested reason for this scarcity is that the Swedish domestic market has been rather small, where the ownership structure has been dominated by large institutional investors. La Porta et al (1998) ranked Sweden among the countries with the highest ownership concentration in his study covering 27 developed countries. [25] The largest shareholder controls on average (median) 37.6% (34.9%) of the votes and the second largest 11.2% (8.7%). The most common type of largest,

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[22] Boesky, Ivan F., (1985), *"Merger Mania"*, p.79
[23] Boesky, Ivan F., (1985), *"Merger Mania"*, p.79ff
[24] Fortune, July 23, 1983
[25] La Porta, R., Lopez-de-Silanes, F., Schleifer, A., (1998), *"Corporate ownership around the world"*, National Bureau of Economic Research Working Paper No. 6625

controlling owner is a family or private persons. These owners control almost 41% of all listed companies at the Stockholm Stock Exchange, SSE.[26] As a consequence, a large proportion of the corporate takeovers have been accomplished through negotiated deals between dominant owners.

The first successful hostile takeover in Swedish history was when Trendinvest acquired Fagersta in 1977. Only two years later Beijerinvest made a bid for Företagsfinans, yet due to the fact that a consortium, containing the main shareholders in the target, made a counter-bid, the takeover failed. During the ten year period between 1979 and 1989 approximately 15 hostile bids were announced, yet only four turned out to be successful. These include AB Volvo's acquisition of Cardo in 1985, Gota's purchase of Wermlandsbanken in 1987, Nordstjernan's obtainment of ABV in 1988 and the same year when Esselte acquired Enström.

However, even though there have not been many successful hostile takeovers in Swedish history, I wish to emphasize that Swedish companies in 1998 spent more on acquisitions abroad than foreign spent on acquisitions in Sweden.[27] The transformation of the Swedish business sector in recent years illustrates how national boarders are becoming increasingly irrelevant to the large corporations. This also has consequences for how Swedish companies are owned and controlled. The era when a small group of business executives and financier families have unlimited control of Swedish business is probably coming to an end. As a consequence, hostile bids and takeovers will become more and more frequent in Sweden, where AB Volvo's midnight raid for Scania AB and OM Stockholmsbörsen's hostile bid for The London Stock Exchange serve as two fresh examples that support this prediction.

3.4 Who makes a hostile takeover?

"…few mergers are ever completed friendly."

Salter & Weinhold[28]

Among those who have been involved in making hostile takeovers, two major groups can be identified; "corporate raiders" and "traditional companies".

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[26] La Porta, R., Lopez-de-Silanes, F., Schleifer, A., (1998), *"Corporate ownership around the world"*, National Bureau of Economic Research Working Paper No. 6625

[27] Haag, Martin., (1999), *"Merger Mania Hits Sweden"*, Swedish Institute Info Service, June 1999

[28] Salter, M., Weinhold, W., (1988), *"Corporate Takeovers: Financial Boom or Organizational Bust?"* In Coffee jr, J. Lowenstein, L. & Rose Ackerman S. (ed.) *1988 Knights, Raiders, and Corporate Targets. The Impact of the Hostile Takeover*, p.146

Corporate raider is the appellation for private persons or smaller parties with the main aim to identify and acquire undervalued companies within any industry. The goal for this category is to acquire undervalued companies, disjoint them and sell off entities in order to finance the purchase. Corporate raiders see themselves as representatives for shareholders and assert that they hinder management that prioritize scale and power rather than shareholder value. *"Embracing the market discipline argument, they justify their tactics as a battle against the entrenched management. They exploit the greed and gullability of speculators and the appetite of the financial press for excitement."*[29] It was primarily between 1982 and 1986 that these "pirates" infested the markets, financing their achievements through the very effective "junk bonds".[30]

Today the role of the corporate raiders is diminishing and most of the hostile takeovers are made by the traditional industry. The idea is that for example economies of scale, economies of vertical integration, complementary resources, unused tax shields, surplus funds and lower finance costs are strong enough motives behind hostile takeovers that better replace the corporate raider's methods of maximizing shareholder value.

In Sweden we have not seen such a large scale of corporate raiders. One major reason could be the great institutional ownership that we find in Sweden today. The institutional ownership makes it difficult for potential corporate raiders to acquire companies with the motive to free stockholders from an incompetent management. A contributing reason for the scarcity of corporate raiders in Sweden is that larger scale loans of the dignity to acquire a corporation are only available to massive corporations. We do not have financial instruments such as "junk bonds" on the Swedish market.

3.5 Motives behind hostile takeovers

3.5.1 Introduction

There are quite a few published reports that suggest that it is both possible and important to distinguish on the one hand the motives behind hostile takeovers from on the other hand the motives behind friendly takeovers. In the coming section I am going to discuss such a distinction, however, it is also important to keep in mind the above made discussion concerning the more general motives behind takeovers as a whole. Further, in the coming section I have also decided to account for the ideas behind the market for corporate control, the principal agent theory and various ownership structures as I believe these topics are closely related to the motives behind hostile takeovers.

[29] Harvard Business Review, September-October 1985
[30] Drucker, P.F., (1986), *"Corporate Takeovers – What is to be done?"*, The Public Interest, p.75

3.5.2 Synergy and Discipline

In June 1987 the National Bureau of Economic Research published a report concerning different motives behind hostile as well as friendly takeovers. In the report, Vishny et al. (1987) claim that there are two main categories of motives behind corporate takeovers in general, namely disciplinary motives and synergetic motives.[31] Vishny et al. (1987) mean that it is the motive behind a takeover that determines its mood. The report shows that disciplinary takeovers are more often hostile and synergetic takeovers are more often friendly, aiming to benefit from combining the businesses of two corporations. As I showed in chapter 2, *"synergy gains can come from increases in market power, from offsetting profits from one firm with tax loss carryforwards of the other, from combining R&D labs or marketing networks, or from simply eliminating functions that are common to the two firms. The combination of the two businesses is thus essential for realizing the gains in synergistic takeovers."*[32]

The purpose of disciplinary takeovers, on the other hand, is to correct non-value maximizing (NVM) practices of managers of target firms, such as excessive growth, excessive diversification and overpayments to employees, thus creating a necessary hostility.[33] Disciplinary motives imply that an acquiring corporation believes that it can govern a target better than the current management, where companies with depressed values are taken over by better regimes. In such a hostile takeover situation the acquirer aims at taking control of the targets outstanding equity, and as a result it also gains the power to sack acting management teams. *"By allowing shareholders to sell their shares to a potential acquirer, the market for corporate control poses a threat to slacking management"*,[34] where the hostile takeover is thus only the most effective way to change control and with it the target's operating strategy. Disciplinary motives thus suggest that a slacking incumbent management will be replaced by an effective one in a hostile takeover situation.

This grouping of motives is naturally not limpid. Even acquisitions with synergetic incentives may meet hostility from the target management and board due to discontent concerning the offered price or the expected changes in the long- and short-term strategy of the corporation. Likewise, disciplinary takeovers may meet positive and accepting reactions from target management and board, for example when the offered price is believed to be sufficient. These

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[31] Vishny, R.W., Schleiffer, A., Morck, R., (1987), *"Characteristics of Hostile and Friendly Targets"*, National Bureau of Economic Research, Working Paper No. 2295
[32] Vishny, R.W., Schleiffer, A., Morck, R., (1987), *"Characteristics of Hostile and Friendly Targets"*, National Bureau of Economic Research, Working Paper No. 2295, p.1
[33] Vishny, R.W., Schleiffer, A., Morck, R., (1987), *"Characteristics of Hostile and Friendly Targets"*, National Bureau of Economic Research, Working Paper No. 2295, p.1
[34] Molin, Johan., (1996), *"Essays on Corporate Finance and Governance"*, Stockholm School of Economics, p.14

gray areas should be interpreted as to show that it is the offered price combined with the target management's valuation of its own presence in office which in the end can have a decisive impact on whether a deal turns out to be friendly or hostile. The stock market can thus be seen as a market for corporate control, where the highest bidder and toughest seller compete for the possibility and right to control a company's resources. Thus, when the incentives of these acting parties deviate, hostility is likely to arise.

Closely linked to the idea that a stock exchange can be seen as a market for corporate control, creating possibilities and motives for hostile takeovers, is the so-called principal agent theory which Jensen and Meckling accounted for in the late 1970's, and for which I am going to account for below.[35]

3.5.3 The Market for Corporate Control and the Principal Agent Theory

"The directors of joint stock companies, however, being the managers rather of other people's money than of their own, it cannot be well expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company".[36]

The above problem, which Samuel Adams identified already in 1776, is what Jensen and Meckling two hundred years later described as the *"principal-agent theory"*.[37] Jensen and Meckling mean that the corporation's owners (the principals, i.e. shareholders) have appointed an agent (management) to control the company. If the incentives of the agent controlling the company are incorrect, the interests of the owners and the agent will deviate, resulting in an agency conflict. Further, in reality, in a world where complete contracts are impossible to create, shareholders have no possibility to fully monitor the actions and decisions made by the agent, creating a risk that incorrect incentives of management could lead to inefficient decisions, destroying shareholder value. This lost value is called agency costs, and the only situation where agency costs are completely eliminated is when the firm is wholly owned and managed by one person.

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[35] Jensen, M.C., Meckling, W.H., (1976) *"Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure"*, Journal of Financial Economics, 3, p.305-360

[36] Smith, Adam., (1776), *"The Wealth of Nations"*, In The Theory of Corporate Finance, p.35

[37] Jensen, M.C., Meckling, W.H., (1976), *"Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure"*, Journal of Financial Economics, 3, p.305-360

Since a manager, according to Jensen and Meckling (1976), does not always have the fulfilling of the interests of the owners as his main goal, the owner will be forced to spend resources on some kind of a monitoring system in order to keep track of the agent's behavior.[38] It is here that the market forces enter the discussion. The threat of a hostile, disciplinary takeover, conducted at the market for corporate control, namely the stock market, is a strong incentive for managers to remember to place the shareholders' interests before their own. Normally internal control mechanisms keep agent costs at bay, yet when this is not so, the corporation becomes a target for a hostile takeover. By appointing a management that better acts in the interests of the shareholders, the new owners can thereby minimize the agency costs.

Among management there is often a harsh resistance against hostile takeovers, as their self-interest drive them to reject such a bid even though it would be beneficial to other parties involved, such as owners, employees and the industry as a whole. A successful tender offer is often profitable to both the seller and to the acquirer, however the case is not always so for the management. *"The smaller the managers' share in the enterprise, the more the managers' interests diverge from the interests of those who contributed capital"*.[39]

Conclusively, the conflict of interests between shareholders and management, i.e. ownership and control, is quite a strong disciplinary motive behind hostile takeovers. It is a fact that, in many cases, the managers of a company that is faced with a hostile takeover bid confront a risk of being replaced after a completion of a change in ownership. *"Within three years of an acquisition, half of all managers at targets are out of work"*.[40] They may also loose the opportunity to carry out their long-term strategies for the corporation. In order to stay in office a management must therefore minimize the agency conflict and thereby minimize the disciplinary motive for a corporate takeover.

Davidson (1985) has vigorously concluded the above discussion in two brief points, grouping the functions of hostile/disciplinary takeovers:

1. Hostile takeovers replaces incompetent managers
2. Hostile takeovers threaten to replace all managers that do not act in the interests of the shareholders.[41]

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[38] Jensen, M.C., Meckling, W.H., (1976), *"Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure"*, Journal of Financial Economics, 3, p.310
[39] Easterbrook, F. H., Fischel, D. R., (1996), *"The Economic Structure of Corporate Law"*, p.22
[40] Easterbrook, F. H., Fischel, D. R., (1996), *"The Economic Structure of Corporate Law"*, p.162
[41] Davidson, K.M., (1985), *"Mega-Mergers, Corporate Americas Billion-Dollar Takeovers"*, p.32

3.6 Ownership Structures and Agency Costs

3.6.1 Introduction

In the light of the motives behind hostile takeovers and the conflict of interests between ownership and control, it is also, especially in Sweden, important to note the fact that it is the ownership structure of a corporation that determines the character and degree of the agency conflict, thus affecting the efficiency of the market for corporate control. Attaining certain ownership structures, as I am going to show, can quite effectively hinder disciplinary takeovers, stopping the head motive behind hostile bids. The ownership structure determines who controls the company and the incentives of the controller determine what decisions are to be made, and as I mentioned earlier, the only situation where the agency costs are completely eliminated is when the firm is wholly owned and managed by one person. In order to provide an overall understanding of how ownership structures affects the agency conflict I am in the following going to describe three main structures.

Table 1. Ownership structures and agency conflicts

Ownership structure	Agency Conflict	Limiting factor
Dispersed ownership (DO)	*Manager vs. owner*	*Takeover threat*
Controlled structure (CS)	*Controlling owner vs. other owner*	*High ownership Stake*
Controlling minority structure (CMS)	*Controlling owner vs. other owner (severe)*	*No limiting Factor*

Above, in table 1, three different ownership structures are summarized with the main agency conflict in each respective structure. When the ownership is *dispersed*, the resulting main agency conflict is between strong managers and weak owners. In a *controlled structure*, ownership is more concentrated, which leads to an agency conflict between the strong controlling owner and the weaker owners. In a *controlling minority structure*, the concentrated ownership is characterized by controlling minority owners, who have little capital in the company yet many votes. The resulting agency conflict in the latter case is a more severe controlling owner vs. other owner conflict.

In the coming three sections I am going to describe each of the above mentioned structures in order to illustrate how corporate structures affect the agency conflict which can result in non-shareholder value maximizing decisions. I also wish to emphasize how the corporate structure and the agency conflict have significant impact on both target's and raider's abilities to take action in hostile situations.

3.6.2 Manager vs. Owner Conflict

Table 2. Dispersed ownership structure (DO)

Ownership structure	Agency Conflict	Limiting factor
Dispersed ownership (DO)	*Manager vs. owner*	*Takeover threat*

The major conflict of interest in many countries, and especially in the US, is between the manager and the owners. Such a conflict is the result of a *dispersed ownership (DO)*, meaning that there is a large group of smaller independent shareholders. Berle and Means (1932) argue that as companies grow, the more the ownership becomes dispersed, resulting in weaker owners and stronger management.[42]

The problem with a dispersed ownership is that the holdings of the individual shareholders are too small to justify the monitoring of the management. If a management realizes that it is not being monitored there is a great risk of moral hazard as it might ignore the task given by the principals and instead act according to its own interests. Since the management often has very limited shareholdings compared to the owners, other factors such extractions of private benefits will steer their decision-making. Thus the decisions will not maximize shareholder value, with higher agency costs as an effect.

An example of the agency costs the above mentioned conflict may result in is empire-building. According to the agency theory, shareholder's main concern is maximizing the value of their shares, while the management may have other goals. In a dispersed ownership structure the manager is able to achieve his own goals without the risk of being monitored and sacked. There is greater power and prestige associated with the running of large rather than small corporations. As a consequence, management may, instead of increasing dividends to shareholders, use free funds to take on investments, even if they have negative net present values (NPV). Taking on investments with negative NPV's decreases shareholder value and therefore results in inefficient decisions from a shareholder's perspective.[43]

However, a major factor limiting the focus on private benefits is that management faces the threat of being replaced in a hostile takeover situation or proxy contest. The threat of being replaced after a change in ownership is a strong incentive for managers to act in the interests of the shareholders, maximize shareholder value and thereby minimize the takeover threat.

[42] Berle, A., Means, G.C., (1932), *"The modern corporation and private property"*
[43] Brealey, R.A., Myers, S.C., (2000), *"Principles of Corporate Finance"*, p.1006f.

3.6.3 Conflicts Between Controlling Owners and Other Owners

A concentrated ownership results in a *controlled structure*, CS, where the agency conflict is between the controlling owner and the dispersed other owners. In a CS, there is a controlling owner, i.e. a dominating block-holder, which has a large capital stake motivating monitoring of the management. Consequently the manager – owner conflict is avoided, however, instead of the management, it is a block-holder that controls the company in a CS.

Table 3. Controlled ownership structure

Ownership structure	Agency Conflict	Limiting factor
Controlled structure(CS)	*Controlling owner vs. other owner*	*High ownership stake*

In a principal-agent description, the other owners (the principals) involuntarily entrust the monitoring of the management to the controlling owner (the agent). Since the controlling owner partakes in or assigns the management and board, they can be considered as aligned.[44] If the controller occupies a large quota of the votes, there is a risk that the controlling owner becomes entrenched, i.e. there is no threat of a hostile takeover if the company is mismanaged since it would require the consent of the controlling owner.

In a CS situation the controlling shareholder will aim at maximizing its block-holder value, including possible private benefits that may accompany a block-holding position. In an extreme situation this could mean not maximizing shareholder value, resulting in an inefficient decision-making from a shareholder's standpoint.

However, an important factor that limits the agency costs from a shareholder perspective is that the controlling owner has to share the cost of a potential shareholder value- destruction, shown in the equation below.

$$\text{Block-holder value} = \text{private benefits} + \text{fraction of shareholder value}$$

As an example of the conflict between a controlling owner and other owners, reflect on the following discussion. A controlling owner aims at withholding his control of a Company, with which power and prestige are associated. The controlling owner may see possibilities for expansion that would more effectively maximize shareholder value. To finance such an expansion a seasoned equity offering would be necessary. However, for some reason the controlling owner cannot meet the requirements for funds. The reason for this

[44] Agnblad, J., Scavancar, H., (1999), *"Control in Swedish listed companies"*. Master's thesis, Department of Finance, Stockholm School of Economics.

could be as followed; if the offering is pursued the controlling owner would have his ownership stake diluted and as a consequence control would be lost. Therefore, the controlling owner will identify this risk and block the value creating expansion at the expense of the other owners. From the controller's point of view, there is a social prestige and private benefit of control, which exceeds the loss of value increase of the controller's share holdings.

3.6.4 Controlling Minority Structures

Bebchuk et al. (1999) have launched a third ownership and control structure theory, referred to as the controlling minority structure (CMS).[45]

Table 4. Controlling minority structure

Ownership structure	Agency Conflict	Limiting factor
Controlling minority structure(CMS)	*Controlling owner vs. other owner (severe)*	*No limiting factor*

Bebchuk et al. (1999) propose that this structure creates a larger conflict than the controlled structure (CS) as it has no limiting factor in the form of a takeover threat or high ownership stake. The controlling minority structure (CMS) is the most common structure in Sweden and surfaces in three various configurations; *the dual class share system*, *the pyramid structure* and *the cross-ownership structure*. These three arrangements, enabling a controlling ownership with a limited capital stake, create a large and probably the most severe separation of ownership and control.

- ***The dual class share system*** allows share classes with multiple voting rights. 70% of the companies listed on the Stockholm Stock Exchange (SSE) have dual class shares. 94% of all the listed companies have a voting difference of 1 to 1/10.[46] In table 2 below I give a practical example of a company, Scania AB, with a dual class share system.

[45] Bebchuk, L., Kraakman, R., Triantis, G., (1999), National Bureau of Economic Research Working Paper No.6951

[46] Agnblad, J., Scavancar, H., (1999), *"Control in Swedish listed companies"*, Master's thesis, Department of Finance, Stockholm School of Economics.

Table 5. Scania AB, an example of a dual class share system

10 largest shareholders in Scania AB		
Shareholder	**% of voting power**	**% of shares**
Investor	49,3	27.8
Volvo	30.8	46.0
SPP	4.6	3.1
Svenska Handelsbanken	1.5	0.9
Nordbanken	1.1	1.1
SEB	0.9	1.2
Wallenberg sphere	0.8	3.9
AMF Pension	0.5	0.6
HQ	0.3	0.2
SHB mutual funds	0.3	0.3
Total	90.1	85.1

Source: Scania AB Annual Report 1999

As one can see there are two major shareowners, however their voting powers are quite different. Investor, which owns 27.8% of the shares, has as much as 49.3% of the voting power. Volvo, on the other hand, owns as much as 46% of the shares, yet only has a voting power of 30.8%. This ownership structure is possible due to the fact that Investor owns a larger stake of so called A-class shares (with high voting rights), while Volvo's block consists mainly of B-class shares (with lower voting rights). As a result, Investor can, with a relatively low capital stake, still have operational control over Scania AB.

- ***The pyramid ownership*** is a second way of maintaining control with a limited stake of capital. The structure is based on the idea that by investing in a controlling block in company A, which is a controlling owner in company B, a corporation can indirectly gain a controlling position in company B.

Diagram 1. Illustration of the pyramid ownership structure

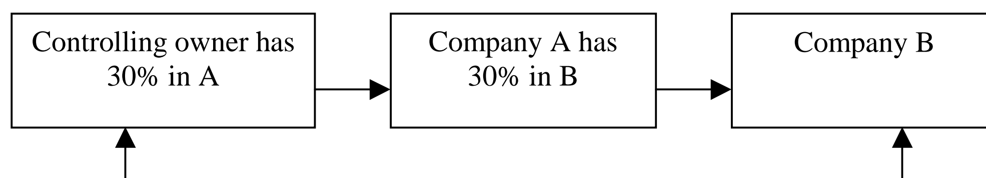
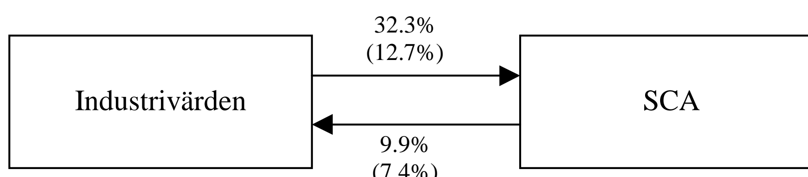


Diagram 1. shows that the controlling owner has 30% of the capital and votes of company A. A holding exceeding 25% of the votes is considered as having operational control of the firm. Company A has 30% of the capital and votes of Company B. As a result, the controlling

owner also has operational control of company B, from which the cash flow rights are 9% (30% * 30%). The result is a separation of ownership and control.

- ***The cross-ownership*** structure builds on the idea that a company A can own shares in a company B, which itself owns shares in company A. The result of this arrangement is that company A in effect indirectly owns itself.

Diagram 2. Cross-ownership structures, an example of Industrivärden and SCA.



Source: Owners and powers in Sweden's Listed Companies, DN Ägarservice

In the above diagram one can see that Industrivärden owns 32.3% of the votes in SCA. The numbers in brackets refer to cash flow rights. SCA in its turn owns 9.9% of the votes in Industrivärden. The setup shows a cross-ownership structure where a company indirectly can own itself.

Bebchuk et al. (1999) mean that the limited capital stake in a CMS makes the incentives of the controlling owner more distorted than in a CS, which results in higher agency costs in a CMS.[47] Since the controlling owner does not share the costs of potential shareholder value destruction, to the same extent as in a CS; there is a higher possibility of incorrect decision-making, with respect to shareholder value. When a controlling owner has a low fraction of the equities, the higher (more than linearly) will be his focus to maximize block-holder value.

Thus, I wish to conclude that the CMS incorporates the problems of the DO and the CS in one structure combined. Like the CS, the CMS protects the controlling owner from the market for corporate control, making it difficult remove him if misbehaving. However, different from the CS, the CMS does not have a controller with a large portion of the cash flow rights, which gives the structure a resemblance to the DO, where the controller is the manager. As a result, the CMS lacks the limiting factors of the two other structures, creating a great gap between ownership and control.

[47] Bebchuk, L., Kraakman, R., Triantis, G., (1999), National Bureau of Economic Research Working Paper No.6951

Therefore, as a conclusion, it is the ownership structure that determines the type as well as the magnitude of the agency conflict. The incentives of the agent determine how close to shareholder value maximization the decision-making will be, having a dominant impact on the necessity of a disciplinary acquisition. As takeovers highlight the conflict between organizational interests and shareholder's interests, it is also important to keep the above discussion in mind when I later on account for manger's incentives and possibilities to defend a corporation against a hostile takeover.

3.7 Characteristics of Target Corporations

3.7.1 Introduction

"If the stock market is to be likened to a casino, an ability to consistently predict takeovers would soon break the bank! It is therefore remarkable that while there have been hundreds of bankruptcy prediction studies there have been only about a dozen published takeover prediction tests."[48]

Is there then something to help a corporation from being involuntarily acquired? As I will come to later, there are several possible tactics to fighting off aggressive bidders, yet this is mainly done on a post bid basis. The question is if there are companies doomed to be targets of hostile takeovers due to certain characteristics and special symptoms. In the context of my thesis this is very important, as the possibility to point out characteristics of companies that are more likely than others to be acquired in an unfriendly way can be a defense mechanism *per se*. By recognizing and being aware of these possible symptoms an attacked company can more easily protect itself.

There have been a few studies made within this area of research, where the results differ as the choice of multiples have not always been aligned. However, important to note is that all of the studies that I have come across agree on one very meaningful point, namely that it is feasible to point out companies that stand a higher risk of being antagonistically acquired, irrespective of employed variables. It has been concluded that targets of hostile and friendly bids have ownership and asset characteristics that one would expect of the targets of disciplinary and synergistic takeovers, respectively, proving that the motive for a takeover determines its mood.

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[48] Barnes, Paul., (1990), Journal of Business Finance & Accounting, Spring 1990, p.73

In accordance with Vishny et al. (1987) I have subdivided the characteristics of hostile takeover targets in two main groups; criteria that are related to the ownership and control structure of a company, and criteria that are more financially related.[49]

3.7.2 Ownership and Control Related Structures

In order for a hostile takeover to be successful, a bidder must convince incumbent shareholders that they are better off selling their shares than remaining owners. The successfulness of these attempts at persuasion has to do with the interests of the shareholders, depending on if they are interested in exerting influence over the corporation, or if they solely see their holdings as financial placements where they will sell their shares in trenchant conditions. These two groups of owners have been classified as "voice" and "exit" owners, where five owner categories can be distinguished based on their preference for voice or exit behavior.[50] The five categories are:

- Institutional investors (such as AP-fonderna in Sweden)
- Private persons with small holdings
- Private persons with large holdings
- Employees of the company, including management
- Foreign investors (including institutional investors)

My aim is not to make a thorough analysis of these groups, however, it can be concluded that friendly takeover targets have been shown to have a substantially higher board ownership than hostile targets, where the stake owned by top officers is in particular high. From a sample of Fortune 500 firms, Vishny et al.(1987) have further concluded that compared to an average firm, a hostile target is much less likely than a friendly target to be run by a founder or a member of a founder's family.[51] Furthermore, the probability of an acquisition, especially a friendly one, rises with management ownership. In fact, intentional exit of a founding family or of a CEO with a substantial stake is common stimulus for a friendly acquisition. Shivdasani (1993) found that equity ownership by a board was merely 4.3% for hostile targets, whilst for non-target companies it was 12.2%. He further concluded that a CEO in general holds over 250% more equity than a CEO of a hostile target.[52]

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[49] Vishny, R.W., Schleiffer, A., Morck, R., (1987), *"Characteristics of Hostile and Friendly Targets"*, National Bureau of Economic Research, Working Paper No. 2295, p.2ff
[50] Hedlund, G., Hägg, I., Hörnell, E., Rydén, B., (1985) *"Institutioner som aktieägare"*, Studieförbundet Näringsliv och Samhälle, Stockholm.
[51] Vishny, R.W., Schleiffer, A., Morck, R., (1987), *"Characteristics of Hostile and Friendly Targets"*, National Bureau of Economic Research, Working Paper No.2295, p.1
[52] Shivdasani, A., (1993), *"Board composition, ownership structure, and hostile takeovers"*, Journal of Accounting and Economics, No.16, 1993

However, even though measures of owner's voice or exit inclination can be very valuable when analyzing companies' hostile takeover vulnerability, it is unfortunately an uncertain multiple as it requires extensive knowledge of each an every single owner, a knowledge that is impossible to inherit. The studies made have shown that the results of ownership identify some clear differences between hostile and friendly targets, yet they do not suggest a clear link between the motive for takeover and its mood. The degree of dilution of the ownership, illustrated in section 3.4, is also a vital ownership and control factor that affects to the possibility of being a target of a hostile takeover. The same implies for such aspects as the age of top officers, the impact of additional outside directorships and the consequences of having CEO's with financial functional backgrounds.

3.7.3 Criteria Related to Financial Multiples

Financial criteria, based on a wide fauna of multiples, generally measure "health" aspects that could make an acquirer interested in a target, irrespective of whether it is technically possible or not. Some multiples are related to the target, however some can be related to the acquirer itself. As I have already mentioned, there are a great variety of multiples which can be used when creating a vulnerability index, however I have chosen just a few, mainly based on Vishny et al's. (1987) study.[53]

Vishny et al. (1987) have used the so-called Tobin's Q-ratio to determine the asset and performance characteristics of target corporations. Tobin's Q is defined as the ratio of the market value of the firm to the replacement cost of its tangible assets. The multiple can be seen as a measurement of a firms intangible assets, such as monopoly power, growth possibilities, management competence, goodwill etc.[54]

In an equation Tobin's Q is calculated as followed:

$$\text{Tobin's Q} = \frac{\text{market value of assets}}{\text{estimated replacement cost}}$$

Vishny et al's (1987) conclusions suggest that targets of friendly bids have equivalent Tobin's Qs relative to those of non-targets, but that hostile targets have lower Qs. Low Qs generally implicate that a firm's tangible assets are crudely utilized relative to their potential. They have

[53] Vishny, R.W., Schleiffer, A., Morck, R., (1987), *"Characteristics of Hostile and Friendly Targets"*, National Bureau of Economic Research, Working Paper No. 2295, p.2ff
[54] Brealey, R.A., Myers, S.C., (2000), *"Principles of Corporate Finance"*, p.831

further concluded that hostile targets not only have low Qs *per se* within their industries, they also happen to be concentrated in generally low Q industries. In terms of performance variables, friendly targets are also younger and more rapidly growing than hostile targets, making them indistinguishable from the sample as a whole. Consequently hostile takeover targets generally have a lower than average market-to-book value, i.e. Tobin's Q.[55]

Vishny et al. (1987) has further concluded that a firm with low market value relative to its fixed assets stands a greater likelihood of becoming a hostile target than the average firm. This appears to be accounted for by an industry effect, and not particularly low valuation within each industry. Morck et al. (1988)[56] and Palepu (1986)[57] support this standpoint who in addition also claim that hostile targets are generally smaller than non-targets and that size is negatively correlated to the risk of being acquired.

However, in contrast to Vishny et al. (1987), Morck et al. (1988) and Palepu (1986), Davis & Stout (1992) believe that size does not protect a corporation from becoming a hostile takeover target, based on the idea that the credit markets are becoming all the more deregulated and that cross-boarder transactions are becoming more and more common.[58] They therefore believe that there today exists an effective market for corporate control, also including corporations of greater size. This standpoint is quite appropriately proven in Swedish OM Gruppen's current bid for the much larger London Stock Exchange, LSE.

Closely linked to a discussion concerning market value, comes the commonly used multiple when analyzing corporations, namely the price per earnings ratio, i.e. P/E-ratio. The P/E ratio measures the price that investors are prepared to pay for each dollar of earnings, calculated as followed:

P/E ratio = stock price/ earnings per share

[55] Vishny, R.W., Schleiffer, A., Morck, R., (1987), *"Characteristics of Hostile and Friendly Targets"*, National Bureau of Economic Research, Working Paper No. 2295, p.2ff
[56] Morck, R., Schleifer A., Vishny, R., (1988), *"Characteristics of Targets of Hostile and Friendly Takeovers"*. In Alal J. Auerbach (ed.) Corporate Takeovers: Causes and Consequences
[57] Palepu, K., (1986), *"Predicting Takeover Targets, a Methodological and Empirical Analysis"*, Journal of Accounting and Economics No. 8
[58] Davis, G., Stout, S., (1992), *"Organization Theory and the Market for Corporate Control: A Dynamic Analysis of the Characteristics of Large Takeover Targets, 1980-1990"*, Administrative Science Quarterly, Dec 1992

The higher the P/E ratio the greater confidence investors have in the future prospects and performance of the company. A high P/E ratio indicates investors have confidence that the company will maintain and probably improve its current performance in the coming year. Thus, a high P/E ratio has been seen as a factor that reduces the risk for a hostile takeover. However, in most cases the P/E ratio being used in an analysis is that provided by a newspaper, not one calculated by the user. This can cause a number of problems. One side of the equation is historic profit, which is not guaranteed to be a guide of future performance, and the other side is current share price, which changes from minute to minute. A rumor of a takeover will not alter historic earnings but will clearly have an effect on share price, thus creating unbalanced and misleading factors in the ratio. In general, however, I dare to say that hostile targets have shown to have lower P/E ratios than their friendly counterparts.

Davis & Stout (1992) additionally see to the age of a company as a factor that affects the risk of being exposed to a hostile takeover. Davis & Stout (1992) mean that older firms stand a higher risk of being taken under hostile circumstances as *"/.../under conditions of significant environmental change such as those in the 1980s, rigid organization will come to be increasingly out of sync with their environment"*.[59] Morck et al. (1988) agree with this standpoint as they mean that managers in older corporations disinvest in a slower rate than younger entities in order to persevere business the "way it always has been".[60] The authors further believe that solely older corporations are undervalued on the stock markets making them clear targets, however, a standpoint that by all means is not uncontroversial.

3.7.4 Conclusion

As is obvious, there are numerous ways to analyze the many aspects of a company's performance from the information available about it. Most theories have been debated back and forth proving that it is very difficult, if not impossible, to create an exhaustive template of hostile target characteristics. However I wish to conclude from the above referred to literature that hostile and friendly targets are very different types of companies. Whilst friendly targets appear to be a wide range of firms in several industries, hostile takeover targets usually seem to be older, smaller and slowly growing companies. They further seem to have a lower Tobin's Q, i.e. are valued much below the replacement costs of their tangible assets, and invest less of their income. In contrast, targets of friendly acquisitions have financial characteristics comparable to the average Fortune 500 firm and are in general younger than

[59] Davis, G., Stout, S., (1992), *"Organization Theory and the Market for Corporate Control: A Dynamic Analysis of the Characteristics of Large Takeover Targets, 1980-1990"*, Administrative Science Quarterly, Dec 1992, p.614

[60] Morck, R., Schleifer A., Vishny, R., (1988), *"Characteristics of Targets of Hostile and Friendly Takeovers"*. In Alal J. Auerbach (ed.) Corporate Takeovers: Causes and Consequences

their hostile counterparts. Additionally, hostile targets are seldom run by members of a founding family and have lower officer ownership. By way of conclusion, it has also been noted that *"a good way for a company to become a takeover target is to make a series of acquisitions that reduce value but allow the value to be recovered through divestiture. A bidder that realizes it can make money by selling pieces at a profit will likely seize the initiative"*.[61] Thus, old and small, slowly growing, low P/E, low board ownership, and low Tobin's Q, seem to be common symptoms of hostile takeover targets.

3.8 Takeover Strategies

3.8.1 Introduction

Over time a great variety of takeover strategies have been developed, largely as a consequence of the growing number of sophisticated defense mechanisms that have come into use. The takeover battle can be seen as a cats and dogs chase between, on the one hand takeover strategies, and on the other hand defense mechanisms, where the constantly evolving legal systems form the framework within which the battle is fought. In the coming section my aim is mainly to present and describe a number of individual takeover attack strategies, however, even though it is possible to identify certain takeover tactics, it is important to note that they, just like defense mechanisms, often come in mixed varieties and configurations.

3.8.2 Proxy Fights and Tender Offers

Many mergers are negotiated by the two firms' top management and boards of directors. However, the acquiring management can also bypass the heads of the target firm and directly approach its stockowners. There are two ways of doing this. Firstly, a dissident group of directors can seek the support of the target's stockholders hoping to gain proxy, i.e. the right to vote their shares. This procedure is a waged campaign aiming at replacing an existing board of directors through a voting contest, a maneuver referred to as a proxy fight.[62] Proxy fights are often used when a bidder does not have the financial capacity to acquire substantial amounts of stock, instead he "leases" other stockholder's voting rights. However, proxy fights are difficult to win, have turned out to be very expensive and drastic increases in stock prices have been common effects.[63]

Instead, the prevailing weapon in contested takeover battles is said to be the tender offer, a method that was mainly developed in the US during the 1970's. *"A tender is the cash offer by a corporation, individual, or other legal entity made directly to shareholders of another*

[61] Harvard Business Review, November-December 1994
[62] Brealey, R. A., Myers, S.C., (2000), *"The Principles of Corporate Finance"*, p.960
[63] Jensen, M., Ruback, R., (1983), *"The Market for Corporate Control"*, 11 Journal of Economics, p.7

company in exchange for the shareholders' stock (either for all or part of their holding)."[64] The tender offer, being the fastest of merger transactions, results in certain advantages for an acquirer in hostile situations. In the 1970's, prior to the introduction of regulations concerning tender offers, such tenders were sometimes accomplished and completed within a week. Further, in spite of disclosure prerequisites, tender offers give hostile bidders certain possibilities to act in secrecy as less information about the companies involved in such transactions is available to the public.[65]

In the 1970's tender offers became very popular, where wars between competing companies could drive premiums to 60 percent and more above the stock market prices. Due to the popularity of these offers a need for regulation was strongly recognized. In 1968, by the initiative of New Jersey Senator Harrison A. Williams, the Congress passed the first federal regulation on tender offers, the so called Williams Act. The act, an amendment to the Securities Exchange Act of 1934, introduced a seven-day minimum waiting period before a tender offer could expire as well as it authorized the Securities and Exchange Commission to introduce disclosure requirements on tender offers.[66] Effectively, hostile tender offers have gone through vast developments in order to adapt to the constantly changing legislative environment as well as due to continually evolving defense mechanisms. As a consequence, a great variety of tender offers can be found on today's market for corporate control, where the coming section, based on Boesky (1986), describes the most common of these strategies.[67]

- *Saturday Night Special*: As the Williams Act required a seven day interval between the announcement of a tender offer and its deadline, investment bankers soon developed the so called Saturday Night Special. The use of this strategy meant that offers were made public on Saturdays, preferably during the evening, implying that the effective working time for preparing a response was reduced. The first time the Saturday Night Special was used was when the American firearms company Colt announced a public tender for all the shares in Garlock. The regulation regarding the Williams Act has been changed since then, now a 20-day interval is required from the announcement to the deadline.

- *The Bear Hug*: When the Saturday Night Special, due to changes in regulation, lost its main function, a new strategy called the Bear Hug was introduced. The Bear Hug meant that the acquiring corporation sent a letter to the management of the target company expressing its wish to purchase the target to a premium higher than prevailing market

[64] Boesky, Ivan F., (1985), *"Merger Mania"*, p.78
[65] Boesky, Ivan F., (1985), *"Merger Mania"*, p.77
[66] Ffrench, H.L., (1986), *"International Law of Take-overs and Mergers"*, p.54f

price. The catch was that the letter also reminded the target management of its fiduciary duty to act in the interests of its shareholders, cornering the target management. The latter was "bear hugged" into a problematic situation where they were practically forced to make the letter public, thus giving the shareholders the opportunity to sell their shares to a very often advantageous price.

- *Open-Market Purchases*: As business conditions were cyclically poor and stock markets deflated it was soon concluded that a management did not breach its fiduciary duties just because it decided to turn down a "bear hug" offer. The fiduciary responsibility was fulfilled as long as managers acted in "good faith" towards the shareholders, eliminating the bear hug as an effective takeover strategy. However, due to the fact that open market purchases of shares were not classified as tender offers and as a consequence not restricted by state or federal regulations, potential acquirers started to purchase shares in the target before taking further hostile action. These "creeping tenders" had several advantages. Firstly they gave the acquiring company a corner position, giving a stronger foothold for a future battle, secondly the cost of acquisition was reduced as the first block of shares were purchased at market price. Thirdly, if the tender offer would fail or if a higher competing offer were to be announced, then the bidder at the least would profit from its first purchased block of shares. The tactic resembles AB Volvo's raid in January 1999 against the competitor Scania AB when 12.85 percent of the latter's shares where purchased on the open market before any further intentions were announced.[68]

- *Two-Step Tender*: In the 1980's, when stock market prices inflated, the two-step tender became popular. In a two-step tender offer an acquirer would first, with cash, buy a controlling corner position, often 50 percent, in the target company. Thereafter, the acquirer would merge the two companies by paying for the remaining stock with a package of fixed income securities, thus acquiring the rest of the company at a reduced, below market price. *"The acquirer was able to reduce the cash costs and also pay less for the remaining half of the company, all with securities"*.[69]

- *Leveraged Buy-Out (LBO)*: A leveraged buy-out (LBO) is an acquisition in which a large part of the purchase price is debt-financed and the remaining equity is privately held by a small group of investors. Leveraged buy-outs differ from ordinary acquisitions in two different ways. First, a large fraction of the purchase price is debt financed, where some,

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[67] Boesky, Ivan F., (1985), *"Merger Mania"*, p.75ff
[68] Dagens Industri, 990116
[69] Boesky, Ivan F., (1985), *"Merger Mania"*, p.93

often all, is junk, that is, below investment grade. Second, the LBO goes private, and its shares are no longer traded on the open market. *"In general, a LBO is defined as the acquisition, financed largely by borrowing, of all the stock, or assets, of a hitherto public company by a small group of investors"*, usually institutional investors.[70] In some cases the investor group is led by the company's own management, creating a so-called *management buy-out* (MBO). Further, the buying group often forms a shell corporation, which acts as the legal entity in the acquisition.

In the 1970's and 1980's many management buy-outs were arranged for unwanted divisions of large, diversified companies. However, in the late 1980's the LBO and MBO activity shifted to buyouts of entire businesses, including large, mature public corporations. One of the most well known and the worlds largest hostile LBO ever was when Ross Johnson, CEO of RJR Nabisco, prepared a group of investors to buy all of RJR's shares and take the company private. The deal crystallized views on LBO's, the junk bond market and the takeover business as a whole. In many ways it exemplified all that was wrong with finance in the 1980's, especially the willingness of raiders to carve up established companies, leaving them with enormous debt burdens, basically to get rich quick. The RJR deal turned out to lead to severe layoffs, great interest charges and a net loss of $979 million.[71]

One of the most keenly anticipated upcoming buyout is the spin-off of German Messer Greishem, an industrial gas business, two-thirds owned by life sciences group Aventis. The business is expected to fetch around Euro 3 bn, which means that it will be one of the most significant German LBO's ever seen to date.[72]

3.8.3 Conclusion

As I mentioned earlier, it is quite common that many of the above-discussed takeover strategies come in various combinations and configurations. Obvious is also that the tender offer as a takeover strategy has gone through a vast development where new tactics have constantly evolved. It has over time been a constant race between legislation, takeover methods as well as defense mechanisms. The takeover tender battle has been resembled to a complex game of poker where the difficulty is to decide whom the rules should protect. The difficulties of formulating a comprehensive regulation of takeover bids are further increased by the fact that there are several kinds of bids, which are constantly evolving. Thus, the

[70] Weston, J.F., Chung, K.S., Hoag, S.E., (1990), *"Mergers, Restructuring and Corporate Control"*, p.393
[71] Burrough, Bryan., Helyar, John., (1989), *"Barbarians At The Gate; The Fall of RJR Nabisco"*, p.481
[72] Financial Times August 31, 2000

development of the legislature on the area is closely followed by newer and more sophisticated takeover strategies, where every major investment banking and law firm across the globe has a department that makes its living and earns its reputation by promoting or defending against mergers and acquisitions.

Important to note, however, is that in the long run, all takeover legislation, irrespective of country, must aim at safekeeping shareholder's interests and effective markets, especially the market for corporate control. As a consequence, strict offer period timetables and rigid disclosure guidelines have been set up in most developed countries, aimed at singling out first come, first served bids and other unfair and unjust tender offers. Therefore, in order to perceive a comprehensive picture of the limits within which tender offers must be strained, I am in the coming section going to account for the merger legislation, regulation and control in the US, the UK and Sweden respectively. Other stock market related orders that regulate the process from bid to closing, such as offer timetables and disclosure requirements, will also be natural ingredients in the coming discussion.

4. Takeover Legislation, Regulation and Control

4.1 Introduction

As I mentioned earlier, the two main purposes of contemporary takeover regulation are the safekeeping of shareholder's interests and the conservation of effective markets, especially the market for corporate control. The economic reasoning for the protection of shareholders must be based upon a cost of capital argument. La Porta et al. (1997) have in a recent study verified that the valuation and breadth of both equity and dept capital markets increases with the condition of the legal protection of investors.[73] Meager protection could lead to that investors are excluded from the takeover gains or even realize loss. However, such cost of capital motives do not characterize the regulatory debate, instead shareholder protection is commonly motivated by fairness and equality considerations.

Those who encourage rigid takeover regulation generally mean that bids are made by raiders and speculators who mainly wish to acquire corporations cheaply in order to either misappropriate the target's assets to their own favor or liquidate it. They see the takeover as a means of depriving employees as well as the community as a whole of the benefits related to the existence of the corporation. On the other hand, those who oppose regulation, argue that takeovers are infrequently made by speculators, instead, they argue that the acquirers are companies who wish to purchase existing corporations that they believe they can manage more efficiently. They further contend that even the mere threat of a takeover can press an incumbent management to improve the performance of the target company.

Important to note, however, is that both sides emphasize the importance of the shareholders and shareholder value. One side deplores the use of the takeover bid as denying the shareholders the time to fully consider their decision and their managers of an opportunity to advise them. The other side, in contrast, means that surprise is fundamental as the acting management has the advantage and time in its favor. In what follows is that economic arguments in favor or against regulatory measures promoting takeover activities is closely linked to the efficiency question. The more efficient one considers the takeover mechanism, the more one promotes the market for corporate control. Accordingly, takeover regulation should not just simply permit takeovers, regulation should also aim at making takeovers increasingly inviting to potential bidders. If one is an opponent of this standpoint, one considers that the rules should be designed in a way to hinder takeovers.

[73] La Porta, R., Lopez-des-Salinas, L., Schleifer, A., Vishny, R.W., (1997), *"Legal Determinants of External Finance"*, Journal of Financial Economics, 29: 315-335

The above discussion is an attempt to illustrate that there are no clear guidelines for the implementation of the two major goals of takeover regulation. Within the regulatory bodies, there is a consensus that neither an unconditional promotion nor a complete curtailment of takeover activities seems appropriate, where different solutions can be revealed in the different legislatures. Sweden, like England, has adopted a self-regulating system for the regulation of takeovers, whereas for example the USA, Canada and France have enacted statutory regulation.

In order to have a full understanding of the takeover defense tactics that can be used in the US, the UK and Sweden I believe it is necessary to have a picture of the takeover legislation in each of these countries. As a consequence, the following section is aimed at giving such an illustration where a description of the offer timelines and other linked legal requirements that have impact on takeovers in each of the three countries will be made.

4.2 US Legislation, Regulation and Control

4.2.1 Introduction

In the US, takeovers are regulated under a dual regime of federal and state laws. On the federal level it is the federal government that enacts the statutory provisions for the issuance and distribution of securities. In addition, the Federal Securities and Exchange Commission (SEC) can enforce federal rules and has circulated several regulations, forms and releases on the basis of authorizations given in the federal legislation. In certain circumstances, depending on the rule, federal rules can also be enforced by an opposing party in a hostile takeover or by shareholders who bring an action on their own behalf. Important to note here is the fact that takeover activity and securities trading is so inter-linked that they cannot be separated. Legislation and regulations have sought to carry over to the takeover activity of recent years the philosophy of the securities acts of the 1930's, and as a consequence, in order to have a full comprehension of the takeover legislation, it is also necessary to have a picture of the major securities laws.

4.2.2 Securities Laws

The securities law exists because of unique informational needs of investors. Securities are not inherently valuable; their worth comes only from the claims they entitle their owner to make upon the assets and earnings of the issuer, or the voting power that accompanies such claims. The value of securities depends on the issuer's financial condition, products and markets, management, and competitive and regulatory climate. Securities laws therefore attempt to ensure that investors have accurate information of the type of interest they are purchasing and its value.

In this takeover context the federal securities laws are primarily seven, and as interesting note, six of these were enacted in the seven-year period between 1933 and 1940. The reason for this concentration in time was the stock - market crash of 1929 and the continuation of depressed markets in the years that followed. Both houses of Congress saw a great severity in the fact that a great number of investors lost immense amounts of money during this period, which soon resulted in the enactment of the securities acts of 1933 and 1934.[74] Thus, the seven statutes we find today are:

- Securities Act (SA) of 1933
- Securities Exchange Act (SEA) of 1934
- Public Utility Holding Company Act (PUHCA) of 1935
- Trust Indenture Act (TIA) of 1939
- Investment Company Act (ICA) of 1940
- Investment Advisers Act (IAA) of 1940
- Securities Investor Protection Act (SIPA) of 1970

As mentioned above, the securities legislation of the US primarily aims at rendering legal regulations that entitle maximum amounts of pertinent information to be disclosed to shareholders of a target corporation, and reasonable time for reflection of this information. At the same time its basic policy is not to exceedingly or unjustly restrain the tender offer process to the point where tender offers will become unfeasible.

In the following section I am going to, in short, summarize the contents of the above listed securities acts as well as their areas of applicability.

The Securities Act of 1933 has primary responsibility for the sale of securities to the public and for the recording of information through the registration of public offerings of securities. Registration demands extensive disclosure about the offeror's past, present and future affairs, and the Act strictly circumscribes what information can and cannot be given. Section 5(c) states: *"It shall be unlawful for any person/.../to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security"/../ "All participants in preparing the registration statements are*

[74] Weston, J.F., Chung, K.S., Hoag, S.E., (1990), *"Mergers, Restructuring, and Corporate Control"*, p.532

subject to legal liability for any misstatement of facts or omissions of vital information".[75] The 1933 Act is supplemented by state statutes, called "blue sky laws" that regulate capital raising within each specific state.[76]

The Securities Exchange Act of 1934 established the Securities and Exchange Commission (SEC) to govern the securities laws and to control the purchases and sales of securities. The SEC was from the beginning crucial to the form of the legislation. The SEC was mainly occupied with the effects tender offers had on the investors from whom securities were solicited. The SEC's view is that, to maintain the confidence of the public in the completeness of the securities market, to make the investors available as sources and allocators of capital, and to maintain the stock exchanges as locations for the exchange of wealth, investors should have the possibility to make acquaint and unhasty choices as whether to sell or to hold their shares. *"Thus the SEC urged that investors be given all essential information, for example, about the identity, background, financing support, and future plans of the offeror, and about any side arrangements with target management. No pressure of any kind, the Commission opined, should come from any quarter. First-come, first served bids were singled out for criticism on this ground"*.[77]

Thus, the Securities Exchange Act of 1934 requires that issuers, subject to certain exemptions, register with SEC if they want to have their securities traded on a national exchange. Companies are "deemed" public according to the SEC when they:

- Have total assets exceeding $10 million and a class of equity security held by 500 or more people.
- Are either engaged in a business that effects interstate commerce or have some securities that are traded by use of any instrumentality of interstate commerce.

These public issuers of securities registered under the 1934 Act must file various reports with SEC in order to provide the public with adequate information about companies with publicly traded stocks. The 1934 Act also regulates proxy solicitation and requires that certain information be given to corporation's shareholders as a prerequisite to soliciting votes. The Act further permits the SEC to promulgate rules and regulations to protect the public and investors by prohibiting manipulative or deceptive devices or contrivances via mails or other means of interstate commerce.[78]

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[75] Weston, J.F., Chung, K.S., Hoag, S.E., (1990), *"Mergers, Restructuring, and Corporate Control"*, p.532
[76] Henn, H.G., Alexander, J.R., (1983), *"Laws of Corporations"*, p.843f
[77] Ffrench, H.L.,(1986), *"International Law of Take-overs and Mergers"*, Quorum Books, p.54
[78] Ffrench, H.L.,(1986), *"International Law of Take-overs and Mergers"*, p.68ff

The Public Utility Holding Company Act (PUHCA), introduced in 1935, regulates holding companies with subsidiaries which are electric utility companies, or which are engaged in the retail distribution of natural or manufactured gas. The aim of the Act *"was to correct abuses in the financing and operating of electric and gas public utility holding company systems and to bring about simplification of the corporate structures and physical integration of the operating structures"*. [79] The Congress believed that there were, during the time of enactment, abuses within the industry that had negative effects on the national public interest as well as on the interests of investors. In order to create these public giants promoters and bankers often used pyramidal capital structures through unscrupulous, fraudulent and deceptive practices. Thus the fundamental purpose of the Act was to free operating companies, subsidiaries, from the defected control of holding companies, allowing them to be more effectively governed by the states. *"Unlike the 1933 and 1934 securities acts, the thrust of the Public Utility Holding Company Act is not limited to disclosure. The 1935 Act is much more of a corporate chartering statute, insofar it imposes substantive requirements upon the registrant's operations."*[80] In a takeover context this is important exempt holding companies are indirectly covered by the Act, as they risk losing the exemption if they purchase a significant non-utility business which is not functionally related to the operation of the utility system. However, many believe that the Act has outlived its usefulness and that it should be annulled.[81]

Like PUHCA, the *Trust Indenture Act of 1939* was enacted to protect the national public interest and the interest of investors. An indenture is the contract that identifies the rights of all parties concerned in a bond issue, issues that are frequent in debt financing when corporations borrow small amounts of money from a large number of investors. As *"exculpatory clauses were included in most indentures and rendered bondholders impotent to hold trustees liable even where the trustee's acts or omissions directly resulted in an injury"*, the Act mainly focuses upon the terms of the indenture as the means to its end of bondholder protection.[82] The SEC has further recommended the Congress to amend the Act in order to establish new financing regulations and in order to set new conflict of interest standards for indenture trustees.

The Investment Company Act of 1940, amended in 1970, governs publicly listed investment and security trading corporations. The Act protects investors committing their resources to others for expert handling and diversification of investments that would not be accessible to

[79] Weston, J.F., Chung, K.S., Hoag, S.E., (1990), *"Mergers, Restructuring, and Corporate Control"*, p.533
[80] Hazen, Thomas, Lee., (1985), *"The Law of Securities Regulation"*, p.537
[81] R. B. Mercer 001025
[82] Hazen, Thomas, Lee., (1985), *"The Law of Securities Regulation"*, p.555

them as individuals. *"The basic thrust of the Investment Company Act is to require registration of non-exempt companies and to protect against money manager's conflicts of interest"*.[83] The amendment in 1970 placed additional restraints on management compensation and sales charges.[84]

As the name indicates, the *Investment Advisers Act*, also of 1940 and amended in 1960, regulates the role of investment advisers. The Securities Exchange Act of 1934 regulates broker-dealer relationships through its registration and oversight provisions however non-broker-dealers who give investment advise are not included in these provisions. It is here that the Investment Advisers Act fulfills its purpose as it aims precisely at this category. The Act further regulates the contracts between advisers and their clients, among other things prohibiting contingent fees. As I mentioned earlier, success geared fees were one of the major reasons behind the merger boom in the UK during the late 1980's, fees that thus were prohibited in the US. However, the SEC has been considering changes in its stance towards advisory fees.[85]

The last securities act that I am going to mention in this context is the *Securities Investors Protection Act (SIP)* of 1970. The Act established the Securities Investor Protection Corporation (SIPC) that is empowered to supervise the liquidation of bankrupt securities firms and orders payments for their customers. Just like the Investment Advisers Act of 1940, SIP focuses on the broker-dealer- investor relationship, where the aim is to protect investors in the case of a broker's insolvency. SIPC therefore has two major functions: first it preserves and maintains a fund for the benefit of injured investors, and secondly SIPC becomes a party in procedures aiming at liquidating insolvent brokerage firms. As one can see, here again the focus is set on investor security, where the risk of harm followed by a broker's insolvency and inability to honor an investor's orders is identified.[86]

As is obvious, the federal regulatory regime applicable to takeovers is drawn from a variety of sources, all developed over time. However, the basic instrument for the regulation of tender offers in federal US law today narrows down to five core rules, namely:

- Sections 14(d) and (e) of the 1934 Act, provisions imposing rules regarding the procedural and substantive aspects of tender and exchange offers.

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[83] Hazen, Thomas, Lee., (1985), *"The Law of Securities Regulation"*, p.567
[84] Weston, J.F., Chung, K.S., Hoag, S.E., (1990), *"Mergers, Restructuring, and Corporate Control"*, p.533
[85] Henn, H.G., Alexander, J.R., (1983), *"Laws of Corporations"*, p.841f
[86] Hazen, Thomas, Lee., (1990), *"The Law of Securities Regulation"*, p.418

- Sections 13(d) of the 1934 Act, requiring disclosure of substantial acquisitions or accumulations of equity securities.
- Regulations 14A and 14C, which are proxy rules governing solicitations to shareholders in proxy contests.
- Registration requirements of the 1933 Act, provisions that regulate offerings of securities in takeovers.
- Rule 13e-3 which regulates "going private transactions" involving affiliates of an issuer.

Sections 13(d)-(e) and 14(d)-(e) of the Securities Exchange Act of 1934 are amendments that were adopted by the Congress in 1968, today referred to as the Williams Act, and it would not be wrong or excessive to say that the Williams Act is the heart of contemporary US takeover regulation.

4.2.3 The Williams Act

While the securities acts are more general, the Williams Act specifically aims at regulating tender offers. Prior to the adoption of the Act in 1968 there was virtually no regulation of tender offers at either the federal or state level. Its main objective was to provide protection for investors, by ensuring that the owners of securities that are subject to a cash tender offer both receive adequate information about the adequacy of the offer, and have an adequate period of time in order to evaluate the offer in serenity, without being coerced into tendering their shares. Thus, it attempts to provide for full disclosure in connection with cash tender offers and other techniques for accumulating large blocks of equity securities of publicly held companies. Additionally, an interesting note is that the Williams Act does not define the term "tender offer" nor has it subsequently been defined by SEC regulations.[87] Apparently, the Congress and the SEC foresee that in the future changed business conditions and practices may arise which might be outside the conventional tender offer, if it was defined, but might nevertheless have the same effect as a tender offer on the shareholders, and therefore deserving of control. As I showed in section 3.6, such developments in tender offer practices have also proven to be true.

The Williams Act obliges disclosure on any person who surmounts the limit of 5% in the ownership of stock of a company. The person must, within ten days from the acquisition of a block of shares exceeding 5%, disclose the following information to the SEC:

- His identity and background
- The source of the funds he used for the acquisition

[87] Hazen, T.L., (1995), *"The Law of Securities Regulation"*, p.348

- The number and percentage of the shares already held
- The purpose of the acquisition
- Any arrangements and understandings among those participating in a possible acquiring team.[88]

The Williams Act further presents three basic principles that safeguard the equality between shareholders, especially as the Act aims at providing shareholders with the time and space to make coercive free decisions concerning the opportunity to profit from potential competing bids. Firstly the Act presents the principle of "*all holders and proration*", meaning that even if the shares tendered to the bidder are more than the amount originally desired by the offeror, he will have to purchase them all by dividing the bid premium in equal parts for all tendered shares. Secondly the Act promotes a "*best price rule*", meaning that the bidder must buy all the shares tendered to him at the highest price offered at any time. Thirdly the principle of "*withdrawal rights*" offers shareholders the right to withdraw any of their tendered shares at any time during the tender offer period.[89]

The above discussion is an attempt to in short describe the main security acts that have and do have an impact on the takeover regulation in the US. The reason for the close link to merger and acquisition activity is the fact that takeovers are carried out by means of securities markets. Special characteristics of securities which make them vulnerable to being used fraudulently mandate regulation to increase public confidence in securities markets. As is obvious, the shareholders, in the form of investors, are placed in focus, where the protection of these is essential. The acts have been developed over time and are in many ways products of the ebbs and flows of merger activity that has faced the US during the past century.

4.2.4 State Laws

In addition to the federal legislation, a variety of state laws also apply to takeovers. Some thirty-five states have their own tender offer statutes where the statutes vary in content.[90] However, a common thread is that the statutes more or less aim at protecting local industry from tender offers emerging from outside the particular state. The Williams Act sets a minimum standard of procedural provisions for tender offers from a federal point of view, however, in US law, the regulation of matters of corporate governance is a matter for the states. There are general corporate law provisions implying that mergers must be consummated in accordance with the corporation law of the state in which the target is

[88] Ffrench, H.L.,(1986), *"International Law of Take-overs and Mergers"*, p.68f
[89] Securities Exchange Act 1934, ss. 14(d)-6 and 8
[90] R. B. Mercer 001025

incorporated. State law also determines a director's fiduciary duties when entering into a merger or resisting a hostile takeover attempt. The state statutes are ordinarily found in each state's corporation statute, which applies to companies incorporated in such a state.

Many states have anti-takeover laws designed to make hostile takeovers more difficult, and all states have adopted the above mentioned so-called "blue sky laws" which deal with the issuance of and distribution of securities as well as takeovers in that state. Originally the purpose of these laws were to protect farmers in Kansas from being convinced to buy securities from sly businessmen, securities which were in fact secured by little more than the blue sky.[91] Today the term "blue sky laws" also comprises state laws with the purpose of avoiding abusive tactics in connection with hostile takeovers, and apart from the state regulation of hostile takeovers, the securities regulation found in the state laws are less restrictive than the federal securities laws. Amongst various types of state anti-takeover laws, the following are the most common:

- Control share acquisition statutes which deny voting rights to a purchaser that acquires more than a specified percentage of a target's stock, unless permission of the target's unaffiliated shareholders is obtained at a special meeting (27 states have laws of this type).[92]
- Business combination or moratorium statutes which prohibit a purchaser that acquires more than a specified percentage of the stock of a target from engaging in a second step merger with the target for a specified period (33 states have laws of this type).[93]
- Constituency statutes which allow, and sometimes even require, a board of directors, when deciding whether to enter into a merger or to accept an unsolicited bid, to consider the interests of constituencies other than shareholders (28 states have laws of this type).[94]
- Statutes endorsing defensive action which authorize a target board to adopt a poison pill or take other measures to resist a takeover bid it deems inadvisable (26 states have laws of this type).[95]

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[91]Henn, H.G., Alexander, J.R., (1983), *"Laws of Corporations"*, p.844
[92] R. B. Mercer 001025
[93] R. B. Mercer 001025
[94] R. B. Mercer 001025
[95] R. B. Mercer 001025

The interplay between state and federal law can be quite complex in the context of takeovers. A state anti-takeover law that imposes unduly onerous requirements on potential bidders may be subject to judicial challenge on the ground that it is invalid under the commerce clause of the US constitution or that the federal securities laws preempt it. The state legislation has in several cases been attacked on constitutional grounds based on the supremacy of the federal legislative body and the freedom of federal courts, and as a result certain states have redrafted their statutes as to avoid defects that have been controversial. Further, in addition to the SEC with its administration and enforcement of federal securities laws, there are a few other regulatory bodies that have influence on merger activity. The Federal Trade Commission (FTC) has competence over certain federal antitrust and consumer protection laws whilst the Antitrust Division of the Department of Justice mainly focuses on, as the name alludes, antitrust matters. Moreover, the American stock exchanges, including the New York Stock Exchange, have issued a number of rules regarding to listing as well as trading on the stock exchanges. The vast majority of the rules issued by the stock exchanges are less restrictive than the federal legislation, and as the federal laws and rules are generally the most extensive and detailed, most of my references will be to such laws.

Thus, a response to a tender offer proper would include, in addition to any statutory duties under the securities acts and SEC regulations, the duty to summon other statutes if there is a likelihood that they would be violated and the appeal is in the interests of shareholders. This would then include, amongst others, Antitrust statutes, state tender offer statutes, blue sky laws, margin regulations, stock market provisions and investment company acts. Moreover, for the present, concerning whether state statutes are illegal as trespassing on federal preempted area, or as inhibiting interstate commerce, it appears that the question is an open one.

4.2.5 Making a Tender Offer in the US

As in most other countries, transactions in the US are generally characterized as either friendly or hostile. Friendly transactions are entered into with the approval of the target board, while hostile bids are addressed directly to the target shareholders. The success of a hostile bid is directly related to how much of a premium is offered on the pre-bid trading price, the strength of the target’s takeover defenses and its ability to attract alternative suitors or to create better alternatives.

There is no single timetable applicable to all transactions, instead the parties must time the various steps in a given transaction to comply with all applicable rules, taking into account tactical considerations.

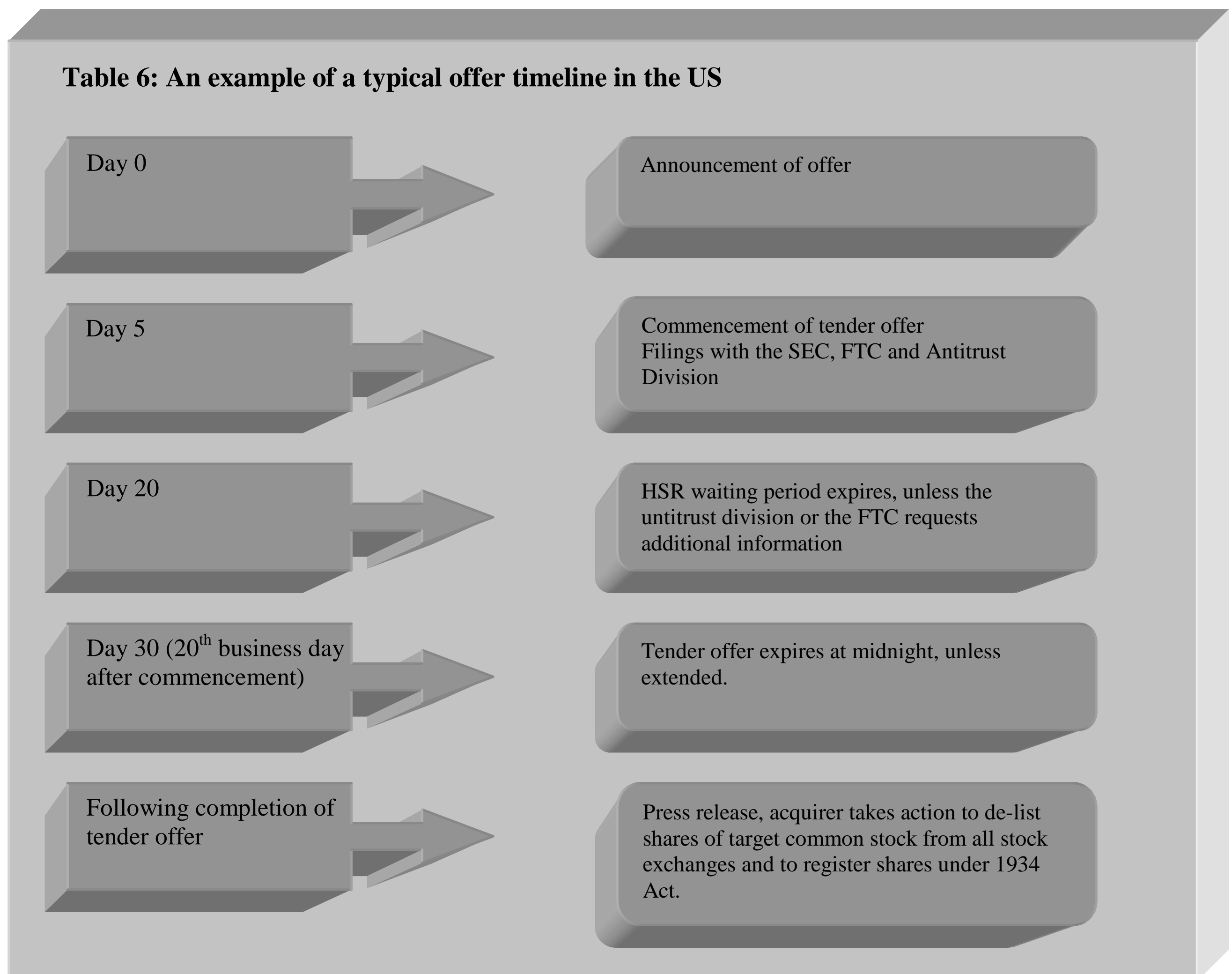

Table 6: An example of a typical offer timeline in the US

Day	Event
Day 0	Announcement of offer
Day 5	Commencement of tender offer Filings with the SEC, FTC and Antitrust Division
Day 20	HSR waiting period expires, unless the untitrust division or the FTC requests additional information
Day 30 (20th business day after commencement)	Tender offer expires at midnight, unless extended.
Following completion of tender offer	Press release, acquirer takes action to de-list shares of target common stock from all stock exchanges and to register shares under 1934 Act.

Source: Handout from Håkan Jonsson, General Council Volvo Car Corporation.

A tender or exchange offer is normally commenced by the publication of a “tombstone” advertisement in a national newspaper and the filing of the offer documents with the SEC. A bidder is free to disclose its bid to the public at any time; although tactically, maintaining secrecy until the proposed terms are set is necessary to preserve the bid’s initial premium.

Except in the case of non-public bear hug, a hostile bid is public by its very nature. When a target receives a non-public offer for a business combination transaction it is not legally obliged to disclose the offer publicly, at least, as long as it has maintained a consistent “no comment” policy regarding merger negotiations and does not trade on its own securities and is not making any offerings of its securities during the course of negotiations. However, if a public announcement is made, it must include all material information regarding the proposed transaction. In the case of a tender offer, exchange offer or proxy contest, voluminous

disclosure is required through filings made with the SEC and dissemination to target shareholders.[96]

A tender offer must remain open for at least twenty business days from the date it is first disseminated to security holders (1934 Act). The offer must be extended for another ten business days from the date of the announcement if the percentage of the class of securities being sought is increased or decreased. The same goes for if the consideration offered is increased or decreased. Other material changes to the offer may require the tender offer to remain open for another five business days, for example in the case of a waiver of the conditions of the offer or in connection with the change in the financing of the offer.[97]

The target in its turn has ten business days from the date the offer is commenced to file a document stating whether it recommends shareholders to accept or reject the offer.[98] The timing differences between hostile and friendly transactions are however both legal and practical. Transactions approved by the target board are generally exempted from applicable state anti-takeover statutes that could otherwise impose substantial delays. Moreover, legal considerations aside, a target's adoption of a poison pill makes it impossible for a bidder to consummate a hostile tender offer. To proceed, a bidder must commence a tender offer and then either persuade the target of the merits of the offer or initiate a solicitation of shareholder proxies to have the target board replaced by nominees of its choosing in order to dismantle the poison pill. The time required to complete the necessary shareholder action will generally greatly exceed the tender offer period prescribed by the federal securities laws and the waiting period imposed by the Hart-Scott-Rodino Antitrust Improvements Act of 1976. In this way the poison pill is designed to give the target board sufficient time to consider all possible alternatives before committing to any particular course of action. Unlike in other jurisdictions, the target board is not obliged to remain neutral and, subject to its fiduciary duties, can adopt tactics designed to frustrate an unsolicited bid.

Certain other regulatory regimes can also affect the timing of a transaction. For example, under the Exon-Florio Amendment to the Defense Production Act, the Committee on Foreign investment in the United States (CFIUS) has the power to review an acquisition of a US company by a foreign bidder to determine whether the transaction could affect national security. Waiting periods imposed under this statute can reach 90 days.[99] Other state or federal

[96] Ffrench, H.L., (1988), *"International Law of Take-overs and Mergers"*, p.67f
[97] Ffrench, H.L., (1988), *"International Law of Take-overs and Mergers"*, p.81f
[98] Securities Act 1933, Rule 14(d)-15(a)
[99] Ffrench, H.L.,(1986), *"International Law of Take-overs and Mergers"*, p.86ff

regulatory approval may be required for transactions involving companies in certain industries such as banking, insurance and telecoms.

A competing bid does not alter the legal timeframe of a transaction. However, a better offer by a competing bidder may dissuade target shareholders from accepting the initial bidders offer and may force the initial bidder to extend as well as increase its own offer. Again, unlike in many other jurisdictions, there is no maximum time period after which an offer may not remain open and in practice, hostile bids often remain open for many months.

4.2.5.1 Stake-building

One of the preparatory steps a bidder may consider is taking an initial stake in the target in the hope that this may improve its chances of success. Although stake-building is permitted and is often desirable, it can raise a number of issues for the bidder under both federal and state law.

Firstly, any person or group of persons that acquires more than 5% of any class of a target's stock must disclose the acquisition within 10 days. Additional purchases of 1% or more require supplementary disclosure. The amount of disclosure required in relation to the acquisition depends on whether the bidder is a passive investor or intends to influence control of the target. [100]

Secondly a stake-building exercise will often give rise to the following additional requirements:

- Acquisitions that would result in the acquirer owning either 15% or more of the target's voting stock/assets, or owning target voting stock/assets with a volume of more than $15 million, cannot be completed unless the Federal Trade Commission (FTC) and the Antitrust Division of the US Department of Justice has been notified and provided with certain information in advance of the proposed transaction and a specified waiting period has expired.[101]
- Business combination and control share acquisition anti-takeover statutes are triggered when a bidder crosses specified ownership thresholds.
- The target's certificate of incorporation may include provisions similar to anti-takeover statutes that limit substantial acquisitions of stock.
- A bidder who crosses a specified ownership threshold may also trigger the target's poison pill and cause a significant dilution of the bidder's voting and economic interest. The ownership threshold will depend on the specific terms of the target's poison pill.

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[100] Securities Exchange Act 1934, Section 13(d)
[101] Hart-Scott-Rodino Antitrust Improvements Act of 1976

- If the target is incorporated in a state with a control share acquisition statute, shares in excess of specified ownership levels (typically 20%, 33.33% and a majority) will have voting rights only to the extent that they are approved by other shareholders.

4.2.5.2 Minimum Levels of Consideration

In general, there is no legal requirement that a bid (hostile or friendly) meet any minimum levels of consideration, however some state anti-takeover laws and target certificates of incorporation contain "fair-price" provisions. For example, the two states of Maine and Pennsylvania have anti-takeover statutes that require a substantial holder to offer to purchase all remaining shares at a statutory determined "fair price", thus resembling what is found in Sweden and the UK.[102]

Prior to launching its bid, a bidder is free to seek irrevocable undertakings from target shareholders to accept the offer. However, in the event that proxies are solicited, the Proxy Rules prohibit the solicitation of more than 10 such holders without filing a proxy statement.[103] A bidder seeking to obtain an irrevocable undertaking from an unrelated holder prior to making a bid should be aware that it risks a solicited holder attempting to induce a third party to make a competing bid. Another early matter for the bidder to consider is whether it intends to offer cash consideration, securities or a mixture of both. There are almost no restrictions on the forms of considerations a bidder can offer. The most commonly applicable state statute is the Delaware General Corporation Law which provides that shares of the target corporation can be converted into *"shares or other securities of the surviving…corporation, [or]…cash, property, rights or securities of any other corporation or entity."*[104] Further, there are no restrictions on the form of consideration that can be offered to foreign shareholders. A tender or exchange offer must ordinarily be equally open to all target shareholders, irrespective if domestic or foreign. However, a bidder can exclude shareholders residing in a jurisdiction in which making the offer would be unlawful.[105]

Following a tender or exchange offer, the bidder will complete a merger transaction in order to eliminate minority shareholders.

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[102] 13A Me. Rev. Stat. Ann. §910; Pa. Cons. Stat. §§2541-48
[103] Hazen, T.L., (1995), *"The Law of Securities Regulation"*, p.298ff
[104] DGCL §251
[105] Rule 14d-10

4.2.5.3 Outstanding Minorities

Ordinarily a bidder that acquires a majority of the voting stock in the target has the right to elect all the members of the target board.[106] If the target has a classified board, i.e. a board in which only one-third of the directors are elected at each year's annual meeting of shareholders, the bidder will generally need to wait until the terms of all the incumbent directors expire, unless the directors resign voluntarily.

A majority stake is usually sufficient to enable a bidder to complete a second step merger without the consent of any other shareholders,[107] although some states require a two-thirds majority approval.[108] Other requirements for a second step merger include the approval of the target board and the distribution of proxy statements to target shareholders. The bidder can usually complete a "short form" second step merger, in which the proxy statement and the shareholder vote is dispensed with, if the bidder's stake in each class of stock is 90% or more before the transaction.[109] For this reason, the time required to complete a second step merger is much shorter if the bidder is first able to reach the 90% ownership level.

4.2.5.4 Target's Response

A target board is free to take action to resist a hostile takeover, although the aggressiveness with which it can pursue its defense can vary considerably from state to state. For example, in Delaware, defensive action must meet an *"enhanced scrutiny"* standard. This means that the target board must show that it had *"reasonable grounds for believing that a danger to corporate policy and effectiveness existed"* as a result of the bidder's offer and that the defensive action taken was *"reasonable in relation to threat posed"*.[110]

In other states, a director's fiduciary duties in the context of a takeover may be much less taxing. Some states, for example, expressly reject any form of enhanced judicial scrutiny of defensive tactics.[111] Other states permit a target board to consider the interests of constituencies such as employees, creditors, suppliers and other non-shareholder constituencies when considering a bid.

Whatever the case in each of the states, there is in US corporate law an all-embracing rule which regulates director's behavior in takeover situations, namely the so called *"business judgement rule"*. The rule corresponds to the proper corporate purpose test in the UK.

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[106] See for example DGCL §216(3)
[107] See for example DGCL §251
[108] See for example N.Y. Bus. Corp. Law §903
[109] See for example DGCL §253
[110] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d.946 (Del.1985)
[111] See for example Ohio Rev. Code Ann. §1701.59

The business judgement rule, deriving from the Revised Model Business Corporation Act, says that director's should act in *"good faith, in a manner that they reasonably believe that is the best interests of their corporation and the care of ordinary prudent persons in a like position and under similar circumstances"*.[112] The rule further builds upon three basic criteria that have been developed through time:

- Directors should act legally, honestly and in such a way as to avoid situations of conflicting interests.
- Director's should under a rational purpose test act in the direction of furthering the interests of the corporation, i.e. the interests of its shareholders should not be "removed from the realm of reason" or "improvident beyond explanation".[113]
- Directors should act in an informed way and with the ordinary care that a prudent person would exercise in managing his own affairs.[114]

The business judgement rule thus protects directors from personal liability and judicial review as long as they act in accordance with the three listed criteria, while, at the same time it encourages them to serve the corporate goal of maximizing shareholder value. The business judgement rule has further developed a system of evaluating takeover defense tactics with the formation of a proportionality test in a management entrenchment hypothesis saying that directors justify the adoption of defensive tactics and enjoy the protection of the business judgement rule if they can show that:

- The bid actually represented a threat to the company and to the welfare of its shareholders; and
- That the defense adopted was both reasonable and proportional as to the threat posed, from an objective point of view.[115]

Keeping the above discussion in mind, in section 5 I am going to more thoroughly analyze target's possibilities to set up specific defense strategies against hostile tender offers.

2.2.3 Conclusion

As is obvious, US regulation of merger and acquisition activity is closely linked to the regulation of securities, primarily because takeovers are carried out by a means of the securities markets. The Securities Act of 1933 and Securities Exchange Act of 1934 provided the framework for later regulation, where most of the more recent legislation has been in the

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[112] Revised Model Business Corporation Act, s. 8.30(a), American Law Institute, Principles of Corporate Governance, s.4.01.
[113] Litwin. v. Allen, 25 NYS 2d 667, Supreme Court 1940
[114] Graham v. Allis-Chalmers Manufacturing Co, 188A. 2d 125, Del 1963
[115] Ffrench, H.L.,(1986), *"International Law of Take-overs and Mergers"*, p.124f

form of amendments to these two acts. Strict disclosure requirements aim to give target shareholders information that will enable them to receive more of the gains associated with the rise in the share price of the takeover target, thus putting the maximization of shareholder value in focus. To the extent that successful tender offers continue to take place, the legislation has achieved its goal of benefiting target shareholders. Increased consolidation has however meant that antitrust and other regulatory authorities are scrutinizing transactions more carefully and are forcing the delay or abandonment of combinations deemed anti-competitive. With proper planning, however, both friendly and hostile transactions can be completed relatively quickly in most cases, maximizing shareholder value.

4.3 UK Takeover Legislation, Regulation and Control

4.3.1 Introduction

In the UK, mergers and acquisitions are primarily regulated by the City Code on Takeovers and Mergers (the City Code) and the Companies Act of 1985. The City Code is a non-statutory set of rules developed by the Panel on Takeovers and Mergers (the Takeover Panel) which is continuously revised and reflects more than 30 years' practical experience of takeovers. Mergers and acquisitions are further affected by relevant standards of the Stock Exchange Rules for the Admission of Securities to Listing (the "yellow book"), the Financial Services Act 1986, Rules Governing Substantial Acquisitions of Shares (SARs), the Fair Trading Act 1973 (which refers to the Monopolies and Mergers Commission), the Criminal Justice Act 1993 and the merger control provisions of the European Council Regulation 4064/89 as ammended in 1997 and 1998.[116]

4.3.2 The City Code on Takeovers and Mergers

The City Code applies to offers for public companies resident in the UK, the Channel Islands and the Isle of Man, irrespective of where the shares are listed and even if they are not listed where their shares have previously been publicly marketed. A public company, according to the City Code, is an incorporated entity that can lawfully offer its shares to the public and obtain a listing on the London Stock Exchange. The City Code also applies to mergers and statutory schemes of arrangements involving a change of control of a UK resident public company. The City Code is further a product of the operation of the Takeover Panel, which is primarily organized by the Bank of England and various other organizations within the City. The Takeover Panel is not a statutory body, it is informal, it lacks defects of bureaucratic structure, but also lacks the power to impose sanctions.[117] Its day to day decision making is conducted by the Panel executive which is composed of experienced practitioners – a mixture of permanent staff and personnel seconded from investment banks, law and accountancy firms.[118]

The City Code consists of 10 general principles and 38 specific rules with guidance notes. The whole of the Code is deliberately expressed in non-technical language and its provisions are applied by the Takeover Panel to achieve their underlying purpose rather than in a narrow text-based manner. The Takeover Panel gives guidance to bid participants and will apply the City Code in the light of the facts of a particular case. It encourages consultation with the Takeover Panel in cases of doubt and expressly discourages participants in takeovers from

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[116] Begg, P.F.C., (1991), *"Corporate Acquisitions and Mergers"*, p.2.1ff
[117] Begg, P.F.C., (1991), *"Corporate Acquisitions and Mergers"*, p.2.16
[118] Palmers Company Law, (1994), Sweet & Maxwell, London, p. D0020

relying on the interpretation of the Code. The City Code has no formal mandatory force of law, yet it reflects the City's thoughts about the way takeovers should be performed.

"*The Code has not, and does not seek to have, the force of law. It has, however, been acknowledged both by government and other regulatory authorities that those who seek to take advantage of the facilities of the securities markets in the United Kingdom should conduct themselves in matters relating to takeovers in accordance with best business standard and so according to the Code. Therefore, those who do not so conduct themselves may find that, by way of sanction, the facilities of those markets are withheld*".[119]

As the Code implies, although it does not have the force of law, breach of it may result in quite serious sanctions being imposed by the Takeover Panel and other UK regulatory authorities. These include the denial of the facilities of the London securities markets and "cold shouldering", i.e. preventing investment banks and others from assisting the party in breach.[120]

The Code is drafted in such a way that it does not directly impose any obligations on the parties that would conflict with their legal duties. However, the courts have recognized that the Code establishes *"objective standards of fairness towards minority shareholders…which the courts should take into account when exercising their own discretion"*.[121] It has also been concluded that, in criminal proceedings, the Code is to be understood in a manner similar to legislation, as an issue of law, and is therefore left to the judge to decide, and not the jury. It has further been ruled that the Panel should be subject to judicial review by the courts, which demonstrates that its activities are considered by the courts to be sufficiently similar to a statutory body that performs public law duties.[122]

The fundamental principles that feature the City Code are twofold. On one hand, it underlines the equal handling of all shareholders, irrespective of size, and for the requirement of adequate information and time for them to decide on the value of a bid, and, on the other hand, the preservation of a fair market for the shares of companies involved in takeovers. As a consequence, the model of regulation is based on the institution of the so-called *mandatory offer*. The City Code includes a set of rules called the SARs (the Rules Governing Substantial Acquisitions of shares). These were designed to restrict so-called "dawn raids" pioneered by

[119] City Code on Takeovers and Mergers 1 (c)
[120] Palmers Company Law, (1994), p.12092f
[121] R v. Spens (CA1991) [1911 1 WLR 624, [1991 4 All ER 421, 93 Cr App R 194, [1991 BCC 140]
[122] R v. Spens (CA1991) [1911 1 WLR 624, [1991 4 All ER 421, 93 Cr App R 194, [1991 BCC 140]

S.G.Warburg & Co in the 1970's.[123] They limit the speed at which a stake of between 15% and 30% of the voting rights of a public company can be acquired before an offer is announced. The restrictions apply to acquisitions which will result in a holding between 15% and 30% and limit these to acquisitions of 10% over any seven day period – unless the acquisition is from a single shareholder, is made immediately before a recommended offer or with the consent of the target board. The SARs apply until a bidder announces its intentions to make an offer.[124] Rule 5 of the City Code applies after this time and during the early stages of the offer. It prevents the acquisition of shares or rights over shares taking a bidder's holding to over 30% of the voting rights unless an exception applies. Thus, the mandatory offer means that a person who has started a tender offer process for a corporations stock, is in the following circumstances obliged to make a mandatory offer for all of the rest of the target's shares:[125]

- If the total amount of the stock he has already acquired represents more than 30 per cent of the company's voting rights; or
- If, in case he previously held a total amount of stock with voting rights between 30 and 50 per cent, this amount increases by more than one per cent within a period of 12 months.

The satisfaction of either one of these two provisions triggers a series of rules regarding the regulation of the mandatory offer, imposing serious restrictions on its terms.

4.3.3 Additional Legislation

As I mentioned earlier, in addition to the City Code and the SARs, there are various other legal rules, statutes and regulations which apply to public takeovers. The Criminal Justice Act of 1993 defines the criminal offence of insider dealing and will affect a bidder's ability to buy shares in a target prior to announcing a bid. The Financial Services and Markets Bill, which replaced the Financial Services Act in July 2000, outlaws misleading statements in connection with takeovers and stock market manipulation. It also requires certain types of investment advertisement issued during an offer to be approved by an authorized financial adviser.[126] Further, the Companies Act of 1985 is the main legislation governing the formation and registration of companies. The Act contains rules which govern, for example, the compulsory acquisition of the minority's shares (once the bidder has acquired 90%); rules requiring shareholders scrutiny of "golden parachutes" for target directors; and rules preventing a UK company from funding operations which support its own share price (even on a fully disclosed basis). The Listing Rules of the London Stock Exchange (LSE) will also be relevant

[123] Begg, P.F.C., (1991), *"Corporate Acquisitions and Mergers"*, p.9.29
[124] Palmers Company Law, (1994), p.12103f
[125] City Code on Takeovers and Mergers, r.9.1a-b.
[126] Schmitthoff, C.M., (1987) *"Palmer's Company Law"*, Stevens & Sons, p.275

if the bidder's shares are listed on the LSE. These require shareholder approval for an acquisition if it is over a certain size relative to the bidder. They will also apply if new shares are being offered as part of the bid consideration that is to be listed on the LSE.[127] Apart from these statutory bodies there are important merger control provisions, where the takeover of a UK company may require approval from the competition authorities of the EU or the UK, as well as there may be sectoral controls controlling ownership in certain sensitive sectors including for example utilities, banking and media.

4.3.4 Making a Tender Offer in the UK

The City Code requires a bid to be notified in the first instance to the target board or to its advisers (*Rule 1*). In a hostile situation, this requirement is often fulfilled through a simple telephone call to inform the Chief Executive of the target (or his investment bank adviser) that an announcement of a bid is about to be publicly released. A copy of the announcement has to be sent to the London Stock Exchange and the Takeover Panel. In contrast with some other EU jurisdictions, there is no need for prior notification to any other body or approval of the offer terms by any public authority.[128]

An obligation to make an announcement, although not necessarily the formal announcement of the full terms of the offer, arises in the following circumstances[129]:

- When a firm intention to make an offer is notified to a target board from a serious source irrespective of the attitude of the board to the offer.
- When a mandatory bid obligation is incurred.
- When, following an approach to a target, the target becomes to rumor and speculation, or there is an ontoward movement in its share price.
- When, before any approach to the target, the target is subject of rumor and speculation and there are reasonable grounds for concluding that it is the potential bidder's actions which have led to the situation (for example, where the bidder's side has allowed the proposal to leak during the course of arranging offer finance).
- When negotiations or discussions are about to be extended beyond a very restricted number of people.

A bidder may only announce a firm intention to make an offer when it has *"every reason to believe that it can and will continue to be able to implement the offer"*[130]. At this stage it will

[127] Schmitthoff, C.M., (1987) *"Palmer's Company Law"*, p.23ff
[128] Palmers Company Law, (1994), Sweet & Maxwell, London, p.12124
[129] City Code on Takeovers and Mergers, Rule 9
[130] City Code on Takeovers and Mergers, Rule 2.5

formally release an announcement of its intention to make an offer (a Rule 2.5 announcement) which will contain:

- The terms of the offer and the identity of the bidder – if a new company is formed for the purpose, details of its ownership will be required.
- Details of shares the bidder owns in the target or which it has contracted to acquire or over which it has options. It must also disclose any derivatives it holds which are referenced to target shares.
- The detailed conditions to which the offer is subject to, for example regulatory clearances.

Announcing a firm intention to make an offer changes the bidder's position fundamentally. It becomes obliged to proceed with the offer within a further 28 days, irrespective of problems which may arise during that period. An offer should therefore not be announced unless the bidder has the resources unconditionally available to enable it to satisfy 100% acceptances.[131]

4.3.4.1 Offer Timetable

Unlike in the US, the City Code prescribes a strict timetable for takeovers to prevent target management from being indefinitely distracted by dealing with a bid and to limit market uncertainty about the fate of the target.

The first key timetable event occurs when the bidder makes the Rule 2.5 announcement. It then has 28 days to post the document containing the offer to the target shareholders (Rule 30.1) although it will usually try to do this more quickly. The City Code prescribes the information to be contained in the offer document. This includes extensive information on the bidder and the target, the conditions and further terms of the offer, the acceptance procedure and information on shareholdings and dealings by the bidder, the target and related concert parties and associates.

The offer must initially be open for acceptance for at least 21 days following the day on which the offer document is posted. (Rule 31.1)

The target board must advise shareholders of its views on the offer as soon as practicable after the offer document is posted and normally within 14 days. On a hostile bid, this advice will often comprise the first defense arguments by the target.

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[131] Palmers Company Law, (1994), London, p.12111

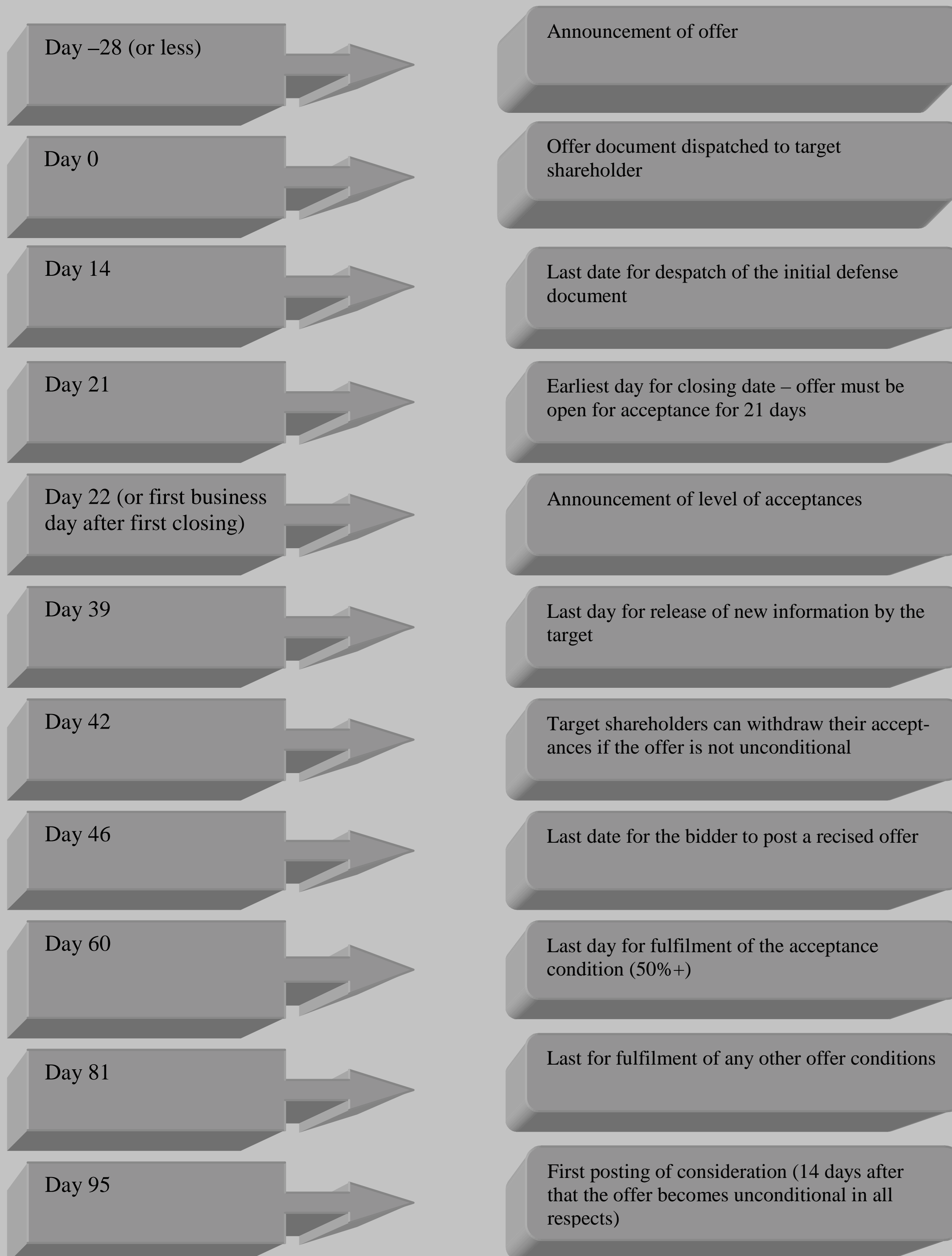

Table 7: Offer Timeline in the UK (Source: Handout from Håkan Jonsson)

Day	Event
Day –28 (or less)	Announcement of offer
Day 0	Offer document dispatched to target shareholder
Day 14	Last date for despatch of the initial defense document
Day 21	Earliest day for closing date – offer must be open for acceptance for 21 days
Day 22 (or first business day after first closing)	Announcement of level of acceptances
Day 39	Last day for release of new information by the target
Day 42	Target shareholders can withdraw their acceptances if the offer is not unconditional
Day 46	Last date for the bidder to post a recised offer
Day 60	Last day for fulfilment of the acceptance condition (50%+)
Day 81	Last for fulfilment of any other offer conditions
Day 95	First posting of consideration (14 days after that the offer becomes unconditional in all respects)

Under the City Code, a bid must be conditional on the bidder acquiring shares carrying more than 50% of the voting rights of the target. The bidder has up to 60 days from posting its offer document to satisfy the acceptance condition, unless the timetable is extended by the Takeover Panel (for example to deal with regulatory delays). At this level a bidder would have effective control of the target and be able to vote through shareholder resolutions, for example, to remove directors. In practice, the acceptance condition will generally be set at higher than 50%, usually 90% of the target's shares, with the bidder retaining the discretion to reduce this to 50%.[132] Where a competing bid is made, the first bidder may not be able to reach 90% within the four month period. In this case the first bidder will have to make a new offer for Companies Act purposes in order to restart the four month period. This may weaken the bidders position in relation to existing acceptances of the first offer – they will be invalidated and will need to be replaced by acceptances of the new one.

The 90% level is chosen because this is the threshold at which the bidder is able to acquire compulsorily the shares of any non-accepting shareholders. Provided the bidder achieves 90% within four months of the date of its offer, it can send notices to any non-accepting shareholders to acquire their shares. (Part XIIIA Companies Act 1985).

As I mentioned earlier, if the bidder acquires shares taking its holding to 30% or more of the voting rights of the target, it will have to make a mandatory cash offer for the rest of the target's shares (Rule 9.1). This obligation will also arise if the holding of the bidder or any group acting in concert with it is between 30% and 50% of the voting rights and any of them acquires any further shares. Such a mandatory bid has to be in cash or include a full cash alternative. The price offered must be equivalent to the highest price paid for any shares in the previous 12 months. A mandatory bid can only be conditional on 50% acceptances and anti-trust matters.[133]

After satisfying the acceptance condition (which happens at between 50% and 100%), a bidder has a further 21 days to satisfy the other conditions to its offer, such as anti-trust clearances. This gives it a maximum of 81 days, assuming the acceptance condition is not satisfied before the 60th day. It must send the offer consideration to target shareholders who have accepted the offer within 14 days after declaring all the conditions to its offer satisfied or waived.[134]

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[132] Weinberg and Blank on Take-overs and Mergers, (1999), p.9045
[133] Weinberg and Blank on Take-overs and Mergers, (1999), p.4239
[134] Weinberg and Blank on Take-overs and Mergers, (1999), p.9045f

Share dealings before and during a bid will also affect the terms of the bid. The offer price cannot be lower than the price paid for any shares in the three months leading up to the beginning of the offer period (Rule 6.1). The Panel may also require the offer price to be no lower than the price paid for any shares bought before this time if it considers this necessary to ensure all target shareholders are treated equally. Also, if the bidder or any concert party buys shares above the offer price during the offer, the bidder will have to increase its offer to all shareholders. (Rule 6.2).

The same timetable applies for both recommended and hostile bids, although more timetable rules tend to come into play on a hostile bid. If the bid is recommended, the offer document will be a joint document and will include the target board's views on the offer. If it is hostile, these will be contained in a separate defense document to be issued within 14 days after the offer document. On a hostile bid, there is likely to be a series of documents issued by both sides as the bid progresses. All communications must be prepared to the high standards prescribed by the City Code. There is also a set date beyond which a target cannot release new defense information (39 days after the date on which the offer document is posted). The last day the bidder can revise or increase its offer is 46 days after that date, giving it seven days to react to the target's final defense arguments.[135]

4.3.5 Target's Response

A target board's ability to defend a hostile bid is circumscribed by company law and by the City Code. For example, the common law requirement that directors use their powers for a proper purpose limits directors' freedom to adopt US style poison pills. There are, nonetheless, certain steps a company can take to prepare for the possibility of an unwelcome approach. These include setting up a defense committee as a committee of the board of directors and assembling a bank of easily accessible key documentation that may assist the defense. The most important defense strategy, however, is to maintain regular contact with major institutional shareholders and for a company to consider carefully its dialogue with analysts and the financial press, yet within the procedural restrictions imposed by the LSE and the City Code on the dissemination of price sensitive information.[136]

From the time at which the board of a potential target company has reason to believe that a *bona fide* offer might be imminent and during the course of an offer, the board cannot take any action which could effectively result in a *bona fide* offer being frustrated or in shareholders being denied an opportunity to decide on its merits. It is often said that these

[135] Weinberg and Blank on Take-overs and Mergers, (1999), p.4157
[136] Weinberg and Blank on Take-overs and Mergers, (1999), p.4155

rules prevent UK companies from engaging in structural defense tactics of the kind which are common in the US. In truth, however, all these restrictions can be relaxed with shareholder's approval. The infrequency of such tactics is probably determined mainly by convention and by lack of confidence on the part of target directors in the chances of shareholders supporting their position.

However, the basic framework for the regulation of the duties of directors in the takeover context is provided by a series of substantial or procedural rules that are incorporated in the City Code.

Firstly, the common law of the UK imposes a fiduciary duty, a *proper corporate purpose test*, on directors to act in the interests of the company as a whole, including the interests of present as well as potential future shareholders. Thus, directors must act legally, in good faith, with due diligence and within both the company's objects and powers and their own powers according to the company's articles. The idea behind the proper corporate purpose test is closely linked to the prohibition of "improper use of powers" which regulates all steps taken by a board, a prohibition that practically affects directors' possibilities to adopt in advance defensive devices against potential hostile takeovers. Further, UK statutory law rules that directors are also obliged to take the interests of the employees into account, a fact that can turn out to be very important in a takeover context.[137]

Secondly, according to General Principle 7 and rule 21 of the City Code, the directors of a target company are required to forgo any *frustrating behavior* as for a *bona fide* offer where a bid has already been made or it is likely that one is on the way. Consequently, the City Code explicitly prohibits issuance of unissued shares, of options on unissued shares, or of securities convertible into shares as well as any purchase or sell-off of assets of material amount and signing of any contracts which do not follow the ordinary line of business. *"The obligation to abstain from frustrating action is a rule of crucial importance that over the last 15 years has set considerable restrictions on a board's ability to adopt defensive tactics as a reaction to hostile bids in takeover attempts"*.[138]

Thirdly, a General Principle 9 requires that directors that are informing their shareholders of an offered bid must act in *good faith*, implying that they should take the interests of

[137] City Code on Takeovers and Mergers, General Principle 9
[138] The Company Lawyer No. 1 volume 29, 2000 p.20

shareholders and employees combined with the interests of creditors into consideration, while neglecting any personal interests.

Lastly, the City Code further includes a series of rules that aim at safeguarding full disclosure of all facts concerning a takeover attempt. All documents and advertisements issued during the course of an offer must satisfy the highest standards of accuracy and the information given must be adequately and fairly presented (Rule 19.1). All documents issued to shareholders and advertisements published in connection with an offer must include a responsibility statement by the directors of the relevant company (Rule 19.2). Shareholders will also receive a defense document from the directors of the target encouraging them to wait and explaining why they should reject the offer and continue to support existing management. If the target engages in structural defense tactics (for example, a major asset disposal, a joint venture or a return of capital to shareholders) there will be additional documents explaining these and seeking the necessary approvals from target shareholders.[139]

Thus, it is apparent that the concept of the UK takeover regulation with its prohibition against *frustrating actions*, concept of *good faith* and with an idea of *proper corporate purpose test* expresses the general spirit of the UK model of regulation, which is based on the idea that any decision regarding takeover defenses should be left to the shareholders and absolutely no action should be taken by the board after a bid is made without their approval.

[139] Weinberg and Blank on Take-overs and Mergers, (1999), p.4168

4.4 Takeover Legislation, Regulation and Control in Sweden

4.4.1 Introduction

As I have already mentioned, Sweden like the UK, has adopted a self-regulatory system for the regulation of takeover bids. Order on the financial markets is upheld through a nexus of laws, public statutes and self-regulatory rules, whereof the following are of most central importance:[140]

- **The Swedish Company Act** ***(Aktiebolagslagen (1975:1385))***: particularly provisions relating to the target board's treatment of its shareholders and provisions relating to compulsory acquisitions. Naturally there are several items in the Swedish Company Act (CA) that can be of great importance in a takeover context, however there are no articles specifically aimed at regulating the phenomenon. In this context it is mainly items CA 8:15 and 9:15 that I wish to emphasize, underlining the important principle of equal treatment of shareholders. CA 8:15 and CA 9:15 declare that a board of directors as well as a management *"/.../may not enter into legal transactions or undertake other measures which are likely to give an undue advantage to a shareholder or a third party to the detriment of the company or a third party."* This principle of equal treatment of shareholders can, as I am later on going to illustrate, have a significant impact on takeovers in Sweden.

  Moreover, following an approval of Bill 1999/2000:34 by the Swedish Parliament on 23 February 2000, it is now possible for a Swedish public company whose shares are listed on a stock exchange, authorized market place or some other regulated market to buy and sell its own shares. The new provisions are primarily covered by the Swedish Companies Act and entered into force on 10 March 2000. Even though the possibilities of buying and selling own shares are limited in several respects and even though it is important that such operations do not have negative impact on confidence in the stock market, the revision certainly effects the possibilities for setting up a defense arsenal in a hostile takeover situation.

- **The Financial Instruments Trading Act** ***(Lagen (1991:980) om handel med finansiella instrument)*** together with regulations from **The Swedish Financial Supervisory Authority** ***(Finansinspektionen)***: particularly in relation to prospectuses and disclosures of share transfers. The Financial Instruments Trading Act requires a purchaser to disclose a shareholding if it reaches or exceeds any of the following limits: 10%, 20%, $33^{1/3}$%, 50% or $66^{2/3}$%. Shares held by related parties, such as relatives and group companies,

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[140] Jansson, P.O., (1995), *"Regelbildning på värdepappersmarknaden"*, p.135ff

will be treated as the acquirer's own shares. Further, the disclosure must be made to the target as well as to the SSE and should cover the purchaser's shareholding after the acquisition, the number of shares acquired and the time of the acquisition.[141]

- **The Listing Agreement for the Stockholm Stock Exchange (SSE)**: an agreement entered by all public companies which prescribes for example disclosure requirements to which listed companies are subject.

- **The Swedish Industry and Commerce Stock Exchange Committee's *(NBK)* Recommendation Concerning Public Offers for the Acquisition of Shares (1999)**: contains the structure, form and timetable for takeovers on the Stockholm Stock Exchange, creating the backbone of the major take-over procedures currently applied in Sweden. The recommendations are included as an appendix to the Listing Agreement of the Stockholm Stock Exchange (SSE) to which public companies listed on the SSE as well as those quoted on the OTC market are obliged to observe. The recommendations are thus of a binding nature and apply to offers for all Swedish companies with widespread ownership. (Due to the significance of these recommendations a more detailed discussion will follow shortly.)

- **Recommendations issued by the Stockholm Stock Exchange Concerning Certain Buyouts of Businesses or Shares From Stock Market Companies, Etc (1991)**: prescribes rules on Management Buyouts (MBO).

- **Merger Control and the EC Merger Regulation**: regulates antitrust issues in Sweden and the European Community. A Swedish takeover may involve the national Swedish competition regime or the EU regime under the EC Merger Regulation. Further, if the target does business or has subsidiaries in other countries, the competition rules of those states may also be relevant. The main Swedish rules are contained in the 1993 Competition Act as amended in April 2000. Notification to the Competition Authority is mandatory where there is an acquisition with an aggregate turnover of the parties exceeding SEK4, 000 million. However, notification is not required if the target has a national turnover of SEK100 million or less. The Authority generally has 30 days from the notification (Phase I) do decide either to clear the merger or to start an extended investigation (Phase II).[142]

[141] Jansson, P.O., (1995), *"Regelbildningen på Värdepappersmarknaden"*, p.153
[142] European Competition Law Review, Volume 20: Issue 7 – November 1999, p.318

- **Regulatory provisions designed to control owners with a qualified holding in certain industries**: for example banking and insurance. In January 1992 the Act on Foreign Acquisition of Swedish Enterprises etc. was repealed. Foreign entities may now acquire shares in a Swedish company without any permission. However, banking and other business' carried out by credit institutions may only be conducted by banking companies and banks that have been granted governmental approval or charter. Moreover, according to the Banking Business Act, the Securities Business Act, the Act on Financial Activities and the Insurance Business Act, an acquisition of a qualifying holding of shares in a Swedish bank, credit market company, insurance company or securities company may only take place with the permission of the Swedish Supervisory Authority. Permission has to be given prior to an acquisition.

- **Regulatory provisions designed to regulate foreign ownership in certain industries**: for example the defense industry. Governmental permission is needed in respect of domestic or foreign acquisitions of Swedish companies engaged in the construction of nuclear plants and certain defence material.

4.4.2 NBK's Public Offer Recommendation

It was in 1971 that The Stockholm Chamber of Commerce and the Federation of Swedish Industries, principals of the Industry and Commerce Stock Exchange Committee (NBK), drew up the first recommendations concerning public offers for the acquisition of shares in and mergers between companies.[143] The recommendations incorporated the basic features of the London City Code on Takeovers and Mergers and fulfilled their objectives until 1988. However, as ownership capital is increasingly of a cross-boarder nature and in view of the competition between various capital markets there was a growing concern that the Swedish market would appear less attractive if Sweden proved to have a regulatory system considered to be less fully developed than other countries. Thus, in 1988 and once again in 1999 the recommendations were revised in order to fill the market's increased information requirements and the extensive developments of the stock markets.

The Industry and Commerce Stock Exchange Committee's recommendations do not aim at equipping the markets with concrete regulations concerning the contents, forms and structure of take-over bids. Instead, just like the Williams Act in the US and the City Code in the UK, they emphasize the importance of providing shareholders with the time and space to make coercive free decisions concerning the opportunity to profit from potential competing bids. Thus, in a takeover context, the recommendation concerning Public Offers for the Acquisition

[143] Jansson, P.O., (1995), *"Regelbildningen på Värdepappersmarknaden"*, p.245f

of Shares (1999) primarily contains two important principles aimed at protecting shareholders. Firstly, Item II.13 stresses manager's fiduciary duties to act in good faith and by the welfare of shareholders. Secondly, Item II.5 stresses the principle of equal treatment of shareholders, resembling the provisions in CA 8:15 and CA 9:15.

Item II.13 reads as follows:

> *"If the board or senior management of the target company has good reason to assume that a serious offer is imminent, due to information received from a person/entity who intends to make a public offer to the company's shareholders, or if an offer of this nature has already been made, the target company may not take any measure regarding the company which is designed to put the issue of the offer or adherence to the offer at risk, unless such measures are approved by a General Meeting of shareholders. However, the requirement of approval by a General Meeting may be waived if it is clearly essential that action must be taken with the greatest possible speed, in view of the needs of the company and its owners."*

Item II.5 reads as follows:

> *"All shareholders with identical terms are to be offered identical compensation per share. However, if special reasons apply in the case of certain shareholders, compensation may be offered to such shareholders in another form, but with the same value."*

A publicly listed company that does not act in accordance with the NBK's recommendations will be in breach of the registration contract of the SSE, where reprisals such as penalty for non-compliance and de-listing are commonplace.[144]

Further, important to note is that the new revised edition of the Recommendation concerning the acquisition of shares (1999) includes a substantial change in relation to the 1988 Recommendation. The 1999 edition namely involves very important rules regarding mandatory offers stating that *"/…/anyone who has less than 40 per cent of the total number of votes in a company, and who obtains 40 per cent or more of the total number of votes in the company/…/must make a public offer for the acquisition of all the remaining shares issued by the target company/…/."*[145] If however the acquirer divests shares within four weeks so that its shareholding amounts to less than 40% of the votes, the obligation to make an offer no longer applies. Moreover, as the mandatory offer is a new factor in Sweden, a need for a supervisory authority in a position to provide unquestioned rulings on the application of

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[144] Fällman, Anders., (1990), "Motåtgärder vid företagsförvärv, Särtryck ur betänkande från ägarutredningen (SOU: 1990:1), p.63

[145] Recommendations Concerning Public Offers for the Acquisition of Shares, Item III.1

provisions concerning public offers has been recognized. This brisk role has been allotted to the Swedish Securities Council (Aktiemarknadsnämnden), *"/.../which may grant exemptions from the provisions, and also interpret the Recommendations in other respects."*[146] The Securities Council is a self-regulatory body that has charged itself with issuing statements on what constitutes good market practice on the Swedish stock market. It has no power to impose sanctions for non-compliance except publicity. Notable is that The Council has made approximately 40 official statements relating to takeovers since its establishment in 1986.[147]

In addition to shareholder protection, NBK recommendations also have disclosure provisions, which in certain ways collide with the disclosure laws of the Financial Instruments Trading Act. The Disclosure Recommendation requires disclosure if the purchaser's shareholding exceeds 5% and any subsequent percentage which is a multiple of five, up to and including 90% of the total number of shares or voting rights in the company. Thus following both the recommendation and the statutory provisions could imply substantial disclosure, especially when passing 30% (statutory and recommendation), when passing $33^{1/3}$% (statutory) and when passing 35% (recommendation). From the NBK's perspective this means that the statutory provisions must be applied on a separate basis, where the following matrix illustrates a few additional situations where such a stance can be called for[148]:

The Act	**The Recommendations**
*only requires disclosure of a change in number of votes;	*also require disclosure in the case of a change in the proportion of the share capital;
*disclosure is to take place when a few percentage thresholds are passed;	*disclosure is to take place when a large number of percentage thresholds are passed;
*calculation of percentage thresholds is exclusively based on shares issued by the company;	*shares which result from the conversion of convertible debt instruments are included in the basis of calculating percentage thresholds;
*reporting is confined to shares;	*apply – in addition to shares – to

[146] Recommendations Concerning Public Offers for the Acquisition of Shares, p.52
[147] Recommendations Concerning Public Offers for the Acquisition of Shares, p. 59ff
[148] Recommendations Concerning Public Offers for the Acquisition of Shares, p.21

however in certain cases other shares are also taken into account.	other types of financial instruments which are equated with debt instruments.

As is obvious, there are no laws or rules in Sweden specifically aimed at regulating the takeover phenomenon. The NBK recommendations are to be applied in parallel with statutory provisions, which certainly can call for mind-teasing complexity, however, the above outline of important laws, rules, recommendations and their interactions respectively will hopefully be clarified later on in section 5 when I place them in specific takeover contexts.

4.4.3 Making a Tender Offer in Sweden

As a point of departure, in Sweden there are no major formal differences between hostile and recommended bids when announcing an offer. According to the Listing Agreement, a target must immediately inform the SSE if it has been acknowledged that a third party has planned to make a public offer for either its shares or other financial comparable instruments. The bidder, on the other hand, must issue a press statement as soon as it has decided to either propose an offer to a general meeting or if it intends to make a public offer. The press statement should include the main terms of the offer, including details of any conditions or other important prerequisites, information as to the number of shares and voting rights that it already owns or controls as well as information concerning to what extent it already has target shareholder approval. Furthermore, the press statement should also include a brief explanation of the reasons of the offer and what effects the offer is believed to have on the bidder's future financial results and market position. There is no obligation to notify the offer to the target before making the press announcement, although this is usually done.[149]

4.4.3.1 Offer Timetable

After the offer has been announced through the press statement, the bidder must prepare the formal contractual offer to shareholders i.e. a prospectus. The period of acceptance stated in the prospectus must be at least three weeks and cannot commence before the filing and publication of the prospectus. On the other hand, there is no stipulated maximum offer period, but it should not be excessively long.

The typical, or rather standard timetable rules apply to both contested and friendly takeovers, however the process may take longer if a competing bid is announced and the target may have to make a statement responding to the second bid. Otherwise
the acceptance period is confirmed in the prospectus and may only be extended if the bidder has reserved the right to do so. Further, unless the offer is conditional, the bidder is obliged to

[149] Wikström. A., Ahlberg, F., (1995), *"Company Law in Sweden"*, p.411

implement the offer. Yet, if the target takes defensive action that makes the implementation irrational or a more favorable bid is launched, the bidder is always allowed to either withdraw or improve its initial offer.[150]

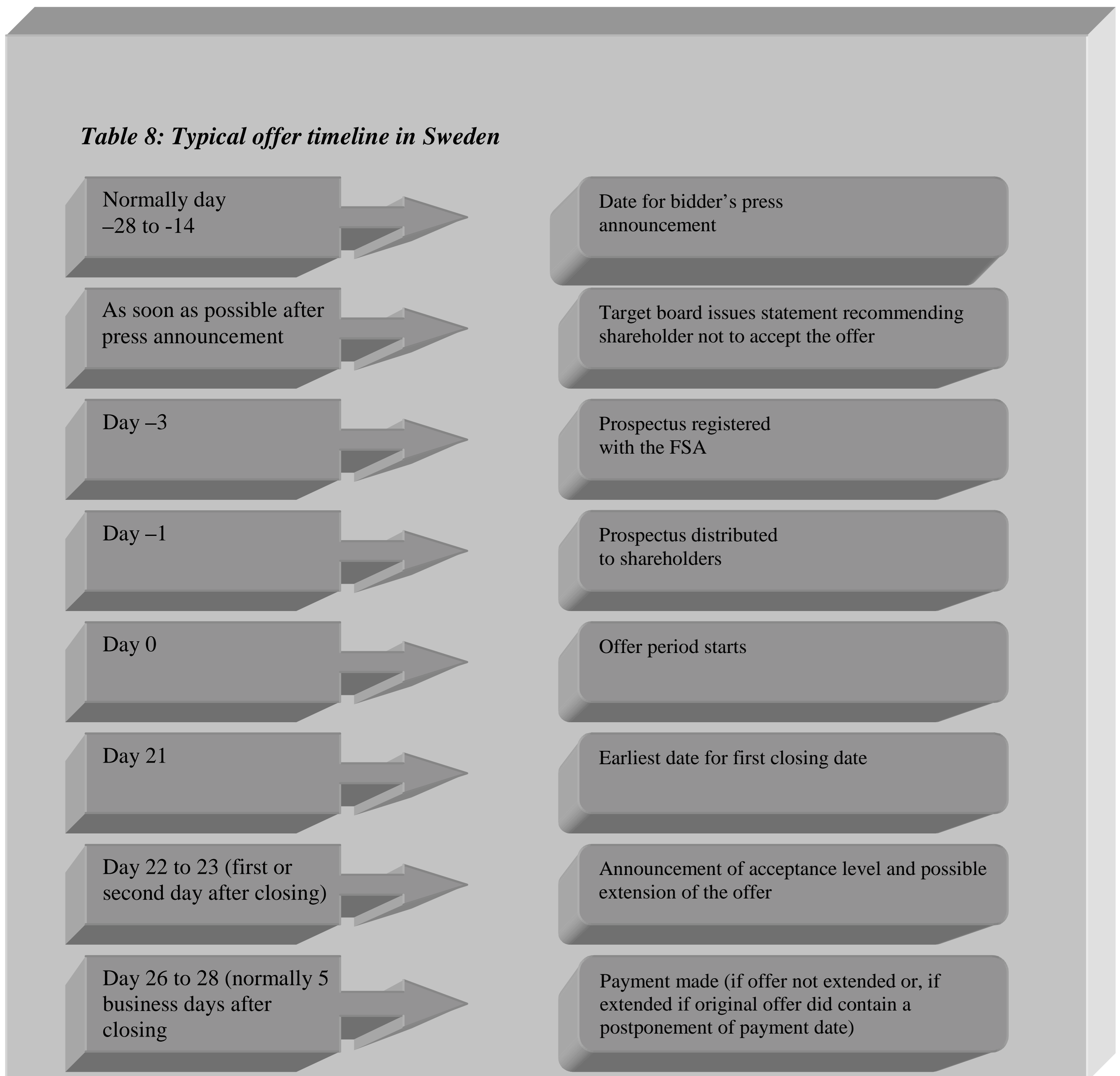

Table 8: Typical offer timeline in Sweden

Time	Event
Normally day –28 to -14	Date for bidder's press announcement
As soon as possible after press announcement	Target board issues statement recommending shareholder not to accept the offer
Day –3	Prospectus registered with the FSA
Day –1	Prospectus distributed to shareholders
Day 0	Offer period starts
Day 21	Earliest date for first closing date
Day 22 to 23 (first or second day after closing)	Announcement of acceptance level and possible extension of the offer
Day 26 to 28 (normally 5 business days after closing	Payment made (if offer not extended or, if extended if original offer did contain a postponement of payment date)

Source: Handout by Håkan Jonsson, General Council Volvo Car Corporation

[150] Wikström. A., Ahlberg, F., (1995), *"Company Law in Sweden"*, p.411

As an interesting note, the stock exchange rules have during the past couple of months come under some pressure in relation to Industrikapital's hostile bid for Perstorp. The battle for control in this deal has realy put the Swedish means of regulation at test. In the case Industrikapital withdrew their bid when they noticed that they had valued the target too high, or rather had valued one of its branches, Pergo, too high. As a result of the conflict the Stockholm Stock Exchange has introduced a new set of stricter rules which have been copied from the LSE. Now, a bid must be substantially financed in the sense that a weaker performance of the target shall not be accepted as an acceptable reason for withdrawal of a bid. Furthermore, target shareholders must have access to the financing strategy of the suitor as well as they have the right to know who the major financiers are. In addition, a failed bid implies that the bidder must wait at least twelve months before a new bid may be introduced, and if the European Commission wishes to investigate a deal according to its competition laws, a bid is frozen up until a maximum of six months.[151]

4.4.3.2 Minimum Levels of Consideration

The acquiring party may want to include unilateral acceptance conditions in its offer, which obliges it also to state that shareholders have a right to withdraw their acceptances. Offers are for example made conditional on obtaining EC and national competition authority approval. In practice, however, an acceptance can be withdrawn at any time until the bidder proclaims that the conditions of the offer have been fulfilled, or, if such an announcement is not made, until the final date of acceptances. Furthermore, in this context I want to once again point out the very important principle of shareholder equality, a principle that is emphasized in NBK's recommendation as well as in the Swedish Company Act. All shareholders holding shares of the same type must be offered identical considerations per share. The purchaser may exclude certain kinds of shares or securities, however a partial offer is only allowed under certain circumstances and each category of shareholders must receive a fair and reasonable treatment. The bidder may, for example, want to make open market share purchases before, during or even after the offer period of a public offering. In principle a bidder is free to do so, however, the acquisitions made outside the offer may not be made on more favorable conditions than the offer itself, unless the offer is adjusted accordingly, all in order to safeguard the principle of equal treatment of shareholders.[152]

4.4.3.3 Outstanding Minorities

The level of voting rights needed to obtain effective control over a Swedish company varies considerably. When it comes to the largest corporations with widespread ownership, the

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[151] Dagens Industri, November 11, 2000, *"Strängare börsregler effter Perstorpaffären"*.

[152] Wikström. A., Ahlberg, F., (1995), *"Company Law in Sweden"*, p.411f

mandatory bid rule benchmark of 40% is probably too high. On the other hand, in medium sized and smaller companies there is often an owner or an ownership grouping which controls more than 50% of the voting power, facilitating the acquisition of control. Further, the Swedish compulsory acquisition rules recognize that once an offer has been accepted by a substantial majority of shareholders, the bidder should be able to buy the outstanding minority and the minority should have the right to be bought out. This is possible as soon as the acquirer owns more than 90% of the shares and votes in the target, where all shares held by a shareholder count towards the 90% threshold, irrespective of when and how they were acquired.[153]

4.4.4 Targets Response

According to the NBK's recommendation Item II.13, the target board cannot take any defensive actions designed to put the issue of the offer or adherence to the offer at risk unless general meeting of shareholders approves these actions. The Recommendation applies from the time the board or senior management of the target has good reason to believe that a bona fide offer is imminent. Only if it is clearly essential that action be taken with the greatest possible speed, in the view of the company and its owners, may the board act without the approval of the general meeting. Thus, after a bid has been launched, the target board can take any defensive action sanctioned by the shareholders in a general meeting and which are in compliance with the Companies Act. The main limitations, as I am going to show in the coming section, are the limitations of equal treatment of shareholders and the company's inherent goal of maximizing profit.

[153] Wikström. A., Ahlberg, F., (1995), *"Company Law in Sweden"*, p.803

5. Defending a Hostile Takeover

5.1 Introduction

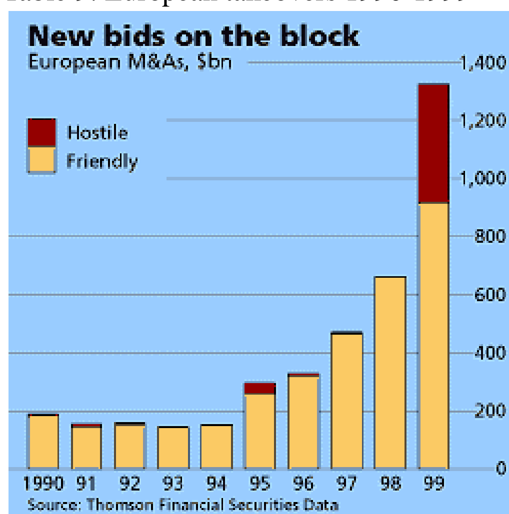
"Imagine you lived in this great old house. You grew up in it, and all your happy memories are in it, and you take special care of it for the next generation. Then one day, you come home to discover it's been turned into a brothel. That's how I feel about RJR Nabisco."[154]

-A former employee after the hostile takeover of RJR Nabisco

Faced with the possibility of a hostile takeover offer, a company's management may ask, "How can we guarantee that any hostile offer will fail?" This is natural, but the normal answer is that you can't guarantee this.

As recently as seven or eight years ago, the chances of a company with a net worth over $1 billion being taken over had seemed relatively slim. The events of 1999 have however proven this assessment to be quite out of date, where Continental Europe led the way with high profile battles for control of companies such as Banque Paribas ($13.2 bn), Telecom Italia ($34.7 bn) and National Westminster Bank ($38.8bn). Yet, in November last year, Vodafone trumped all that had gone before with its $148.6 billion hostile offer for Mannesmann. The size of the Vodafone bid and its ultimate success have sent shock waves through the corporate world. If a German company of the size of Mannesmann is vulnerable, what company is safe from an attack?

Table 9: European takeovers 1990-1999



As one can see, there has been a vast increase in the value of European hostile takeovers during the past year, and inevitably Management across Europe are now questioning how they should respond to the phenomenon of hostile tender offers.

[154] Burrough, Brian., Helyar, John., (1995), *"Barbarians at the Gate, The Fall of RJR Nabisco"*, p.40

5.2 The Nature of Defense Planning

The problem of defense planning is not legal but commercial. In theory, in most jurisdictions around Europe, it is legally possible to put in place arrangements which would give management complete control over the future of their company. For some companies, these structures may be a practical possibility as well, for example, regulatory requirements requiring airlines to have restrictions on “foreign” shareholdings which, in practice, render them immune from hostile takeovers. Other companies have single large shareholders who, for so long as they remain supportive of management, make it unnecessary to spend time seeking anti-takeover devises.

In reality, however, subject to these special cases, it is rarely commercially possible for major public companies to put in place anti-takeover structures. In some jurisdictions, such as Sweden, shareholder consent is required for the necessary changes to the relevant company’s constitution or for the necessary share issues, and institutional shareholders would not normally be prepared to give their support to the relevant resolutions. In other jurisdictions, such as the Netherlands, it may be possible to avoid a shareholder vote but the adverse reaction of shareholders and potential shareholders to any unilateral actions by management could non-the-less severely damage the company.

In addition, even the most theoretically perfect takeover defenses are likely to fail to protect a company in practice if a majority of its shareholders support a hostile takeover offer.[155]

In the US, companies sometimes put in place arrangements, which give the management power, when faced with a hostile offer, to issue shares or take other action without the consent of other shareholders, i.e. poison pills. Experience suggests, however, that although such tactics may delay the success of hostile offers, they do not ultimately in practice allow management to ignore the wishes of shareholders. For commercial reasons, management of a widely held public company simply cannot do this for a long period, even if they can theoretically convince themselves that they are not in breach of their fiduciary duties in doing so.

This points to the real nature and objective of defense planning. Defense planning must, therefore, ultimately be aimed broadly at minimizing the risk that the views of shareholders and management are so far out of line that shareholders will accept an offer which management does not approve. Of course, the best way of doing this lies not in discovering

[155] Interview with Carl Bennett 000830

complex legal structures but in ensuring that the value of the company is fully reflected in its share price and that major shareholders are supportive of the policy to achieve the corporate goals. This approach will not guarantee continued independence, as it is always possible that a "special purchaser" will be able to pay a higher price, like Nestlé's successful hostile offer for Rowntree in the 80's. However it is normally the best long-term defense.

5.3 The Legality of Defense Planning

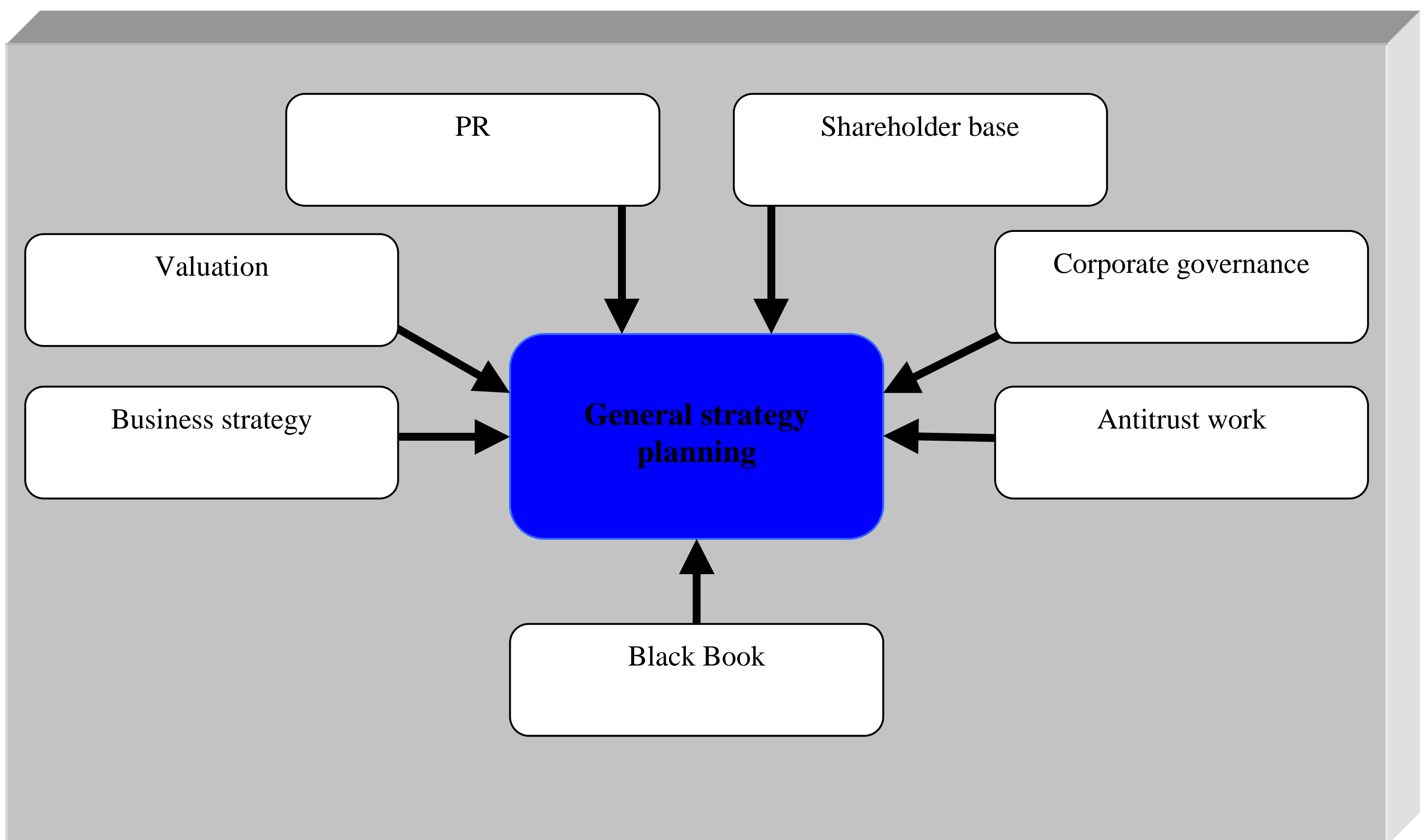
Whatever the jurisdiction, the legal duties of the directors have to be considered in the light of the fact that shareholders of companies frequently want to receive an offer for their shares, particularly if it is a price significantly above the prevailing market price. In almost all jurisdictions, directors of public companies have fiduciary duties, and even if these are expressed in various ways, they amount to the same basic requirement; that directors act in good faith in what they believe to be the best interests of the company. It is questionable whether, in the past, management have always clearly distinguished the proper from the improper motives for their actions, but this does not alter the basic proposition that, conducted for the right reasons, defense planning is normally lawful. Indeed, it could be argued that management have a duty at least to consider the subject since otherwise their shareholders and employees may be seriously prejudiced. Some people go towards the other extreme and either do nothing or assume that defense planning comprises no more than the preparation of a defense manual, i.e. a so called "Black Book". This is however misguided. Having a defense manual to use when a hostile bid is launched is a vital tool but it is not the beginning or the end of the process. Defense planning is an on-going project, part of general corporate strategy.

According to an analyst at J.P Morgan in London, defense planning should therefore cover, among other things, the analysis of:

- The company's own business and business strategy, including how successful it has been and how it could be portrayed by both the company and an unwelcome bidder.
- The company's shareholder base and the relationship with, and the likely loyalty of, shareholders and share price performance.
- Market perceptions of the company including how to bridge any gap between its market capitalization and its intrinsic equity value.
- The values of different parts of the business, both on trading and exit basis, as well as possible reconstruction values.
- Possible predators.

- Possible supportive partners or investors ("white squires") or acceptable bidders ("white knights") or merger partners.
- Antitrust and other regulatory issues and other possible technical defenses.
- Corporate governance and other issues which would prove damaging in an offer context, for example the excessive use of corporate jets and other company assets.
- Employee issues, such as pension arrangement and funding.
- Recognizing the limitations of poison pills and the like.
- The possible impact of a takeover on legal arrangements to which the company is a party, such as joint venture arrangements which may include change of control clauses.

Table 10: The Nature of Defense Planning



The above list and diagram, however, includes relatively limited changes in corporate practice. The defense planning may also suggest the need for more radical action including fundamental changes in business strategy. It may be concluded that, in order to ensure that the full value of the company's business is obtained by shareholders, part of the business should be de-merged (as happened in the case of ICI which, following a hostile stand-off with

Hanson in 1993, concluded that it should de-merge Zeneca).[156] Conversely, it may as well be concluded that independence is no longer a viable option and that an acceptable acquirer or merger partner be sought. Further, as part of the legality of defense planning, it is important to identify the antitrust and regulatory aspects. It is always worth considering whether a defense planning exercise should include antitrust or other regulatory work. Firstly, it may form part of an overall assessment of the risk of hostile action as an analysis of regulatory issues in a specific industry may speedily reach the conclusion that hostile action is effectively impossible. Secondly, regulatory work can be designed to identify regulatory defenses and, to an extent, to prepare those defenses.

5.4 Post Bid Defenses

The first question which a company has to answer following the announcement of an unsolicited bid is "Are we going to resist this offer, if so, on what basis?"

The basic thrust of any company's defense depends on its overall strategy, and if a company cannot establish what that strategy is relatively soon after an offer has been made, its actions, no matter how well presented, will lack coherence.[157] At one extreme, a company may adopt a resolute determination to stay independent. At the other extreme, the directors may recognize that the offer will ultimately succeed and, consequently, focus on securing the highest possible price for shareholders. In between these extremes, the company may believe that it has a viable independent future but recognizes that it would have to recommend acceptance of the offer if it were to be increased. Conversely, it may decide that it cannot remain independent but that there are likely to be better offers available from third parties.

A company has to recognize, of course, that it cannot control its own destiny; its shareholders may prove to have very different ideas about its future than the management; possible "white knights" may prove to be illusory; and the hostile offeror may preempt the situation by either increasing its offer or taking other drastic action. The company can, however, influence the position significantly.

As is the case prior to the announcement of an offer, companies sometimes initially place a lot of hope in finding some cast iron way of defeating the offer, irrespective of the wishes of shareholders. Occasionally, at least in the short term, this proves to be possible, as for example antitrust and other regulators may intervene. In general, however, the search for a

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[156] Brealey, R.A., Myers, S.C., (2000) *"Principles of Corporate Finance"*, p.983
[157] Interview with Lennart Jeansson 000901

cast iron defense is misplaced. In the UK, for example, the Takeover Code states that *"At no time after a bona fide offer has been communicated to the board of the offeree company, or after the board of the offeree company has reason to believe that a bona fide offer may be imminent, may any action be taken by the board of the offeree company in relation to the affairs of the company, without approval of shareholders in general meeting, which could effectively result in a bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits".*[158]

This kind of provision is by no means universal but it is steadily gaining acceptance across Europe, where wordings prohibiting "actions which may result in frustration of the offer" will most surely be widespread once the long awaited 13th Company Law Directive becomes law.[159]

As in pre-bid situations, it is rare for a company to be able to ignore the wishes of its shareholders in the longer term. Consequently, in the vast majority of cases, the most viable defense is successful persuasion of the shareholders into believing that there are good prospects for longer term capital and, possibly, income growth if they hold on to their shares.

As I have declared earlier, it is important to distinguish between pre-bid and post-bid defense tactics, where I have accounted for some of the ideas and principles related to the defense planning which may be necessary in the continuous strategy planning of a corporation. However, in the following section my aim is to more specifically describe and analyze distinct post-bid defense mechanisms a company may come to use. The reason for choosing post-bid defenses is that these mechanisms can be commonly used by most companies, irrespective of ownership structure and company charter. Further, with respect to the increasingly common prohibition against frustrating action, I find it even more important to analyze the possibilities to take use of post-bid defenses.

I have decided to divide the defense mechanisms into four main categories, where the common thrust is that they all come into effect after a hostile bid has been launched, irrespective if they may have been part of a continuous preventive long-term defense. Moreover, after each section a legal comment will follow, clarifying the legal issues in the US, the UK and Sweden respectively.

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[158] City Code on Takeovers and Mergers General Principle 7

[159] See for example also Recommendations Concerning Public Offers for the Acquisition of Shares (1999), Item. II.13

1. **Poison Pills:**
    a) Call Pill
    b) Put Pill

2. **"Lock-up" agreements and "white knights"**
    a) Directed share issues
    b) "Crown jewel"
    c) Golden parachutes

3. **Emergency tactics**
    a) Pac-Man defense
    b) Management led buyouts

4. **Target litigation**
    a) "Showstoppers" and anti-trust defense

5.5 Poison Pills

5.5.1 Introduction

Poison pills, or rather share purchase rights plans, have for long been considered to be the most widely used and successful anti-takeover defensive device that has been adopted by US corporations. A poison pill plan is designed to increase the cost of a takeover and eventually discourage it, by providing the existing shareholders of a company with the ability to dilute the company's equity by purchasing shares at a very low cost, or imposing the acquirer to purchase shares of the existing shareholders at a very high price, as soon as a certain percentage of the company's outstanding shares change hands. These are two types of poison pills that are called the "call" and the "put" plan.[160] Poison pill defense thus "*implies payment streams in the opposite direction to those of voluntarily-dilution schemes.*"[161]

5.5.2 The Call Pill

According to the call pill, the most basic poison pill, a company issues a call option that has the structure of a dividend and is linked to every outstanding share of the company. The option allows its holder to acquire shares of the company within a specified period of time and at a price set at a multiple of the current price of the company's stock and is retrievable by the company at a low nominal price, for example 1 SEK per option. However, the thrust of

[160] Wingerson., M.R., Dorn., C.H., (1994), *"Institutional Investors in the U.S. and the Repeal of Poison Pills: A Practitioner's Perspective"*, Institutional Investors and Corporate Governance., p.211
[161] Molin, Johan., (1996), *"Optimal Deterrence and Inducement of Takeovers: An Analysis of Poison Pills and Dilution"*, Stockholm School of Economics, The Economic Research Institute, p.76

the option is served when the “triggering event” occurs, that is the acquisition by a bidder of a block of shares that exceeds a certain threshold percentage of the company’s outstanding equity, e.g. 20%.[162]

Call pills are further divided into two sub-categories, “flip-in” and “flip-over” plans. The flip-in plan permits shareholders to purchase shares of the target company, and the flip-over plan permits shareholders to purchase shares in the company that will survive after the consummation of a takeover attempt. The latter is made possible through the conversion of target shares to shares of the bidder. Nonetheless, the thrust of both the flip-in and the flip-over plan is that the targets stock is diluted and the block of shares that was already acquired by the bidder is not ample enough to give it control of the target company.[163]

5.5.3 The Put Pill

The put pill, not as widely use as the call pill, allows shareholders to sell their shares to the target company when the triggering event occurs, at a price considerably higher than the targets market price, and sometimes even above the premium offered by the bidder.[164]

5.5.4 Legal Comments USA

The poison pill appeared for the first time in the defensive arsenal of US corporations in June 1983 in the battle of Lenox Inc. with Brown-Forman Distillers Corp. and its rationale has since then been questioned in several proceeding cases. The “cutting edge”, however, of the both the call- and the put- pill is that they are dividend rights paid by the company to the shareholders and since dividends are declared by the board of directors, the board can adopt a poison pill without shareholder consent.[165]

In broad terms, poison pills are legal in the US, yet a series of cases have set certain limitations to its use. Today’s rationale for the adoption of poison pills derives from a Delaware case, Moran v. Household International Inc. (Del.1985) which upheld the adoption of poison pills as defensive tactics in advance of specific takeover attempts.[166] The Delaware Supreme Court appreciated poison pills for non-financing purposes if the issued rights are not sham securities and have real economic value. However, the core of the Court’s decision to accept poison pills *per se*, was that the poison pill did not deny shareholders from their possibility to receive and accept tender offers based on the fact that a bidder can always attempt to buy a company by tendering on the terms that the board will redeem the poison

[162] Christensen, Jan Schans., (1991), *“Contested Takeovers in Danish Law”*, p.345
[163] Christensen, Jan Schans., (1991), *“Contested Takeovers in Danish Law”*, p.345ff
[164] Christensen, Jan Schans., (1991), *“Contested Takeovers in Danish Law”*, p.347
[165] Christensen, Jan Schans., (1991), *“Contested Takeovers in Danish Law”*, p.345f

pill, or on the condition of receiving a maximum number of tendered shares. It has thus been held that the adoption of a poison pill can be considered within the margins of the business judgement rule, as long as they do not solely cause economic loss to the bidder and forget to protect the interests of minority shareholders in making self-interested transactions.[167]

5.5.5 Legal Comments UK

The concept of poison pills as it is known in the US has shown to encounter a number of problems when implemented in the UK and UK companies have proven to be quite reluctant to adopt the poison pill as a defense mechanism. Poison pills fall under the provisions of the City Code and the proper corporate purpose test, where the Code clearly prohibits the target board from, as far as the post-bid period is concerned, granting any options over issued shares of the company, unless they obtain the shareholder's approval. The proper purpose corporate test either accepts or upholds the poison pill based on the criteria whether it preserves the margin of free choice for shareholders and if it upholds effective markets free from distortion. Further, the basic justification in the US of the poison pill is that it safeguards the equal treatment of shareholders and protects the shareholders that unsuccessfully tendered their shares by permitting them to recover through their call- or put- option. However, the City Code has a strict mandatory offer provision, giving shareholders equal treatment and a possibility to tender their shares as a bidder is obliged to acquire all tendered shares to the highest price offered within the past 12 months. Thus, the basic thrust of the poison pill has in the UK been replaced by the mandatory offer. Conclusively, the poison pill, as a post-bid defense mechanism, can only be used in the UK if ratified by shareholder approval.

5.5.6 Legal Comments Sweden

The initial position in Sweden concerning convertible debt instruments and debt instruments with a right of option to subscribe for new shares, such as the poison pill, is that its issuance is regulated by a simple majority of the General Meeting. However, such a decision can be taken by the Board alone as long as it has shareholder approval.

Concerning the flip-in call pill, I dare to say that it is in most cases allowed in Sweden, however, based on a few provisions. Firstly, the conversion rate may not be set lower than the nominal value of the share, unless the difference is covered by a cash payment at the conversion (CA 5:1:3). Secondly, shareholders preferential rights have to be considered as *"at an issue of debt instruments for consideration in cash the shareholders shall have a preferential right of subscription as if the issue involved the shares which may replace the*

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[166] Hamilton, R. W., (1996), *"The Laws of Corporations"*, p.374
[167] Dynamics Corp of America v. CTS Corporation., 794 F.2d 250 (7th Cir.)

debt instruments or which may be subscribed for on account of a right of option."(CA 5:2) A breach of CA 5:2 could further also violate the very important principle of shareholder equality emphasized in CA 8:15 and 9:15 stating that a board of directors or General meeting may not adopt any resolution that is likely to give an undue advantage to a shareholder or third party to the detriment to the company or other shareholders.

The flip-over poison pill, on the other hand, is most likely to violate Swedish corporate law. Mergers between two entities whereby the target is dissolved without being wound up and where its assets and liabilities are taken over by the bidder is not common in Sweden. It is further uncertain to what extent a merger provision in a target company charter may state specific terms of a potential future takeover. Thus, a resolution giving the right to shareholders to acquire shares in a possible hypothetical merged entity is most likely to be unlawful.[168]

Lastly, the put-pill also has certain limitations in Sweden, mainly due to the fact that a Swedish company may only buy-back 10% of its own shares. However, as the right of option to subscribe for new shares, embodied in option certificates attached to the debt instrument, may be separated from the option certificate, a put-pill does not have an injuring effect on shareholders if the option certificate is redeemed in beforehand, making it lawful from a shareholder aspect. Thus, as with many takeover defenses, the put-pill is legal *per se*, yet its lawfulness has to determined from case to case.[169]

5.6 "Lock-up Agreements" and "White Knights"

5.6.1 Directed Share Issues and "Crown-Jewels"

One of the most commonly used defenses which has proven to stand a good chance of succeeding, if not preserving the independence of the target, is the so-called "white knight" defense. Such a defense aims at hindering unfriendly "barbarians at the gate" by seeking and securing more acceptable counter offers from potentially friendly owners, i.e. white knights. White knights are thus companies, occasionally private individuals, who agree to acquire a total or partial ownership in the target company and who are willing to let incumbent management remain in office.[170] A white knight is consequently in agreement with the

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[168] Fällman, Anders, (1990), *"Motåtgärder vid företagsförvärv"* Särtryck ur betänkande från ägarutredningen (SOU 1990:1), p.74
[169] Fällman, Anders, (1990), *"Motåtgärder vid företagsförvärv"* Särtryck ur betänkande från ägarutredningen (SOU 1990:1), p.75
[170] Carroll, C., Griffith, JM., Rudolph, P.M., (1998) *"The Performance of White Knight Management*", Financial Management, 27(2), Summer 1998, p.46f

strategies of the target management and has no – or at least expresses no – intentions to remove management. Moreover, lock-up agreements are the rights granted by a target company to a white knight designed to give the white knight an advantage over the prospective unfriendly bidder to purchase assets or stock of the target at a specified discount price and on terms and conditions settled in advance.[171] Thus, as white knights and lock-up agreements are so inter-linked I have decided to discuss them together.

As an interesting note, until the worldwide recession in the early 1990's, there was no single year in which a majority of European hostile offers eventually succeeded. The reason was not that a majority of companies were succeeding in remaining independent but that, in a large number of cases, the target company found a white knight prepared to pay a higher price than the original offeror. The reason the situation changed in the early 1990's was that white knights were harder to find and so, those companies which were bold enough to launch hostile offers in the middle of a recession, were more often successful than previously. A late example of a European corporation to seek a white knight is Mannesman AG when confronted with Vodafone's hostile bid in November 1999.[172]

White knight and lock-up defenses have been seen to be set up in two major ways:
1) the target can agree to issue new shares directly to the white knight, i.e. lock-ups concerning directed share issues and
2) the white knight can be granted the possibility to acquire vital assets or crucial projects to the target, so-called "crown jewel lock-up agreements".

Naturally there are quite a few risks involved when selling one-self out to a white knight through lock-up agreements. From a managers standpoint, the most significant risk lies in the fact that a white knight may change its mind or turn out to have other intentions than originally expressed. Further, any offeror will want to achieve its aim at minimum cost, and if a substantial premium is offered by the unfriendly raider, the costs to white knights become correspondingly higher and the chance of rescue naturally diminishes. In particular, once it becomes known in the market that a company is seeking a white knight, its prospects in succeeding in remaining independent are slim. The target has, in essence, conceded that it should be taken over and the only questions are "By whom and at what price?" Dorman L.

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[171] Christensen, Jan Schans., (1991), *"Contested Takeovers in Danish Law"*, p.385f
[172] FinansTidningen 19991208

Commons, former CEO of Natomas Company quite well phrased the risks and problems that accompany the searching for a white knight; "*White knight is a picturesque shorthand term – no one buys someone else's company out of chivalry, and no corporate executive ever roamed the countryside assuming great personal risk to rescue innocent in distress. We were simply hoping to find a company interested in a deal that would seem attractive, even a bargain, on their own terms.*" [173] Further, as a bid for example in the US only has to be open for 20 days, a white knight must act quite swiftly reducing the time for a full and thorough due diligence, thus increasing both risk and uncertainty.

Banerjee et al. (1996) have additionally examined multiple-bidder corporate control contests involving late-entry collaborative white-knights. They have employed auction theories to structure the analysis and examine the valuation consequences for bidding firms. Their conclusion is that an immediate white-knight response to a hostile bid is met with a strong, negative market reaction. When the white knight and hostile bidder get into a bidding war with follow up bids by each, the white knight (but not the hostile bidder) loses its bids each time. However, if the white knight bid follows two consecutive hostile bids and the contest ends, there are minimal losses to the white knight, which are statistically indistinguishable from the mildly positive reaction from the preceding hostile bids.[174]

5.6.1.1 Legal Comments USA

In the US, the issuance of new shares to friendly third parties is legally acceptable as long as it is in the interests of the shareholders that the hostile offer be defeated or if there is a sound business purpose in doing so, i.e. according to the business judgement rule. "*Thus, such would be enjoyed, for example, if the motive for the issue of the securities was merely to perpetuate target management.*"[175] However, important to note is the fact that it is a company's charter that states the number of shares a company is admitted to issue. As long as the amount of shares stay within the charter's limits the board of directors may offer new shares to a white knight. If, on the other hand, the issuance increases the authorized capital, shareholder approval is necessary. Further, shareholders preemptive right, i.e. right to preserve the proportionate share ownership of a company by purchasing a proportionate amount of shares of any new issues, is dealt with by state law.[176]

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[173] Commons, Dorman L., (1985), *"Tender Offer, The Sneak Attack in Corporate Takeovers"*, p.67
[174] Banerjee, A., Owens, J., (1996), *"The Impact of the Nature and Sequence of Multiple Bids in Corporate Control Contests"*, Journal of Corporate Finance, December 1996, p.23ff
[175] Ffrench, H.L., (1986), *"International Law of Take-overs and Mergers"*, p.148
[176] Christensen, Jan Schans., (1991), *"Contested Takeovers in Danish Law"*, p. 364

The sale of a crown-jewel in the US is likely to perpetuate the target company's incumbent management in the successor or surviving corporation, clearly presenting the potential conflicts of interest between management's desire to stay in office and the company's best interests. Such a defense tactic is also a matter of state corporate law prohibitions on self-dealings, although the target management's actions will generally have at least the protection of the business judgement rule. In addition to the terms of the lock-up agreement, which must reflect the interests of the shareholders, the timing of the lock-up has a crucial importance on its legality. According to Hastings-Murtagh v. Texas Air Corporation, a crown-jewel lock-up is legal if its terms and conditions have been agreed upon at an early point in time and persuades or facilitates potential bidders to make offers for the company.[177] *"If it is, however, inevitable that the company be sold – and the only outstanding questions are to whom and on what terms and conditions – management is normally not entitled to enter into lock-up agreements since this would inhibit or prevent an auction for the company/…/."*[178] A Delaware ruling has further stated that unless the target has made several attempts to solicit bids from other companies, and unless the crown-jewel lock-up substantially increases the final offer made for the target, the crown-jewel defense is not likely to be for the best of shareholders. Thus, if a crown-jewel defense forecloses rather than promotes competition, the defense is most surely unlawful.[179]

5.6.1.2 Legal Comments UK

In the UK, statutory law is much stricter concerning the process for the issuance of new stock. Before issuing new shares a board of directors should either be expressly authorized by the articles of the company or acquire shareholder authorization in General Meeting. The authority given through the general meeting may extend to a period of five consecutive years, which can be renewed through the same procedure. Further, such authorization may also embody the deferment of the rights of preemption of existing shareholders for the same periods of time. However, even if such authorization has been presumed to the board, it is considered very difficult to argue the good faith and the proper corporate purpose of directors that act within their proxy powers, by issuing new stock. Additionally, the offer to a white knight should be seen in the light of rule 12 of the City Code which states that *"/…/any information, including particulars of shareholders, given to a preferred suitor should on request be furnished equally and as promptly to a less welcome but bona fide potential offeror."* Thus, it is within the continuing duties of a listed company to offer securities to all existing shareholders, when proposing to issue new securities for cash.[180]

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[177] Hastings-Murtagh v. Texas Air Corporation, 649 F. Supp. 479 (S.D. Fla. 1986)
[178] Christensen, Jan Schans., (1991), *"Contested Takeovers in Danish Law"*, p.385f
[179] Hanson Trust plc v. ML SCM Acquisition, (Del. 1988)
[180] Cooke, T.E., (1988), *"Mergers and Acquisitions"*, p.237f

In the UK, crown jewel lock-up agreements are much more rarely used than in the US. The major obstacle to such an agreement in the UK is rule 21 of the City Code, specifying that during the course of an offer, or even before the date of the offer, if the board of the offeree company has reason to believe that a bona fide offer might be imminent, the board *"/.../must not/.../sell, dispose of or acquire or agree to sell, dispose of or acquire assets of material amount/.../."* It is thus obvious that as long as the target management of a corporation in the UK is aware of a hostile tender offer, the crown-jewel is not an alternative defense strategy. However, worthwhile mentioning is that the Code does not hinder a target management from stating/threatening to sell a crown jewel in the future, if the offer fails. In this sense, the target makes itself unattractive, especially if the bidder's main objective is to acquire the crown-jewel *per se*, without a specific interest in the remaining part of the target.[181]

The classic illustration of the use of this tactic was the battle for the control of the Savoy Hotel Limited. The directors of the company, aware that an unfriendly raider was attempting to acquire control through open market purchases and suspecting that the motive was to sell the Berkeley Hotel, i.e. the crown jewel, devised a complicated transaction where the effect was to hinder a potential controller of the Savoy Hotel the right to procure the use of the Berkeley Hotel for any purpose other than as an hotel. The case was investigated by the Department of Trade, who's final view was that the directors had not breached their fiduciary duties when acting bona fide in what they believed to be in the best interests of shareholders. However, the directors acted improperly in the sense that they had used their power to sell the Berkeley Hotel, not for the purpose for which that power was conferred upon them, but *"for the purpose of depriving shareholders of such control as under the regulations of the company they may have over the company's assets"*.[182]

5.6.1.3 Legal Comments Sweden

Involving a white knight in Sweden can be done according to the two above mentioned methods i.e. through directed share issues and through crown-jewel lock-up agreements. Even though both methods *per se* generally are seen as lawful, there are a few legal implications that I wish to discuss, especially concerning directed share issues.

Firstly, the Swedish Company Act regulates the issuance of new shares, where the important principle of equal treatment of shareholders is emphasized. ABL 8:15 and 9:15 state that a board of directors or a General Meeting may not adopt any resolution that is likely to give an

[181] Cooke, T.E., (1988), *"Mergers and Acquisitions"*, p.238f
[182] Weinberg and Blank on Takeovers and Mergers, (1999), p.4192

undue advantage to a shareholder or third party to the detriment of the company or other shareholders. Therefore, the lawfulness of signing a resolution with a white knight in Sweden has to be seen in the light of the equality principle and to the financial impact such a resolution can have on the target. A resolution made by a General Meeting in breach of CA 9:15 can be repealed or altered on the request of a shareholder. A board of director's breach of CA 8:15, on the other hand, can also be annulled, however not as a result of a shareholders disapproval, clearly limiting shareholder's possibilities to oppose boards of director's and management decisions. [183]

The determination to issue new shares is normally a question for the General Meeting, and ordinarily, it has to be bypassed by a simple majority vote. If, however, the newly issued shares exceed the limit of shares allowed by a company charter, the charter will have to be altered, requiring a qualified majority. Disapproval of such decisions can be stressed according to above.

The Swedish Industry and Commerce Stock Exchange Committee has also established recommendations concerning directed share issues. The Committee has recommended that, unless there are special reasons to the contrary, decisions concerning a new share issue which is at variance with shareholder's preferential rights, i.e. a directed share issue, are to be taken by the General Meeting of shareholders of the company and not by the Board, following authorization from the General Meeting. The recommendation does not state what "special reasons" imply, however it has been concluded that a board should be authorized to take decisions regarding a share issue only when *"it is called for in the light of market circumstances/.../or where other special reasons apply."* [184]

Even though the Swedish legal system is quite vague concerning the use of white knights through directed share issues, white knights have at several occasions been used as defenses on the Swedish market.[185] What the Swedish legal system seems to attack are call-options for directed share issues that have been made prior to a hostile tender offer, i.e. pre-bid defenses. Such a defense is seen as circumventing NBK's takeover recommendation II.13 stating that *"if the board or senior management of the target company has good reason to assume that a serious offer is imminent/.../the target may not take any measures regarding the company which is designed to put the issue of the offer or adherence to the offer at risk/.../."* Since a

[183] Fällman, Anders, (1990), Motåtgärder vid företagsförvärv, Särtryck ur betänkande från ägarutredningen (SOU 1990:1), p.75f
[184] NBK, Recommendations Concerning Directed Share Issues, Etc (1986)
[185] See for example in 1995 when Hasselfors screened the market for a white knight after the hostile bid by AssiDomän.

company may enter a call-option before the knowledge of any hostile offer, the recommendation will only apply if the option is activated. In such a situation a conflict of interests will arise between the option and NBK:s recommendation. A breach of the option is a breach of contract, causing claims for damages, and not following the recommendation can lead to de-listing and massive penalties. There is no clear answer to how such a situation is to be ruled, where the rightful action has to be evaluated depending on the perimeter of each specific case.[186]

A Swedish company's possibility to sell a "crown-jewel" completely depends on the effect such an auction has on the company. The principal rule is that the board of directors decides upon the vending of the company's assets (CA 8:6). Doctrine, however, states that if the vending has an extraordinary impact on the company and is beyond the regular business of the corporation, then the question should be left to the General Meeting.[187] Further, important to note is that the core business and the objects of every corporation must be declared in the company charter's articles of association (CA 2:4). Selling a crown-jewel may result in altering the core business and objects of the corporation, an action that needs consent from at least a qualified majority of the shareholders (9:15).[188] Moreover, in the comments to NBK's takeover recommendation II.12 it is subsequently stated that the vending of a crown-jewel should not be a matter for the board of directors, but a matter to be decided a General Meeting. A board acting in breach of this could end up liable for a target's financial loss resulting from the decision (CA 15:1).[189]

5.6.2 Golden Parachutes

5.6.2.1 Introduction

The reason why I have decided to discuss white knights, lock-up agreements and golden parachutes in the same section is that they have one very important common denominator; they all aim at throwing cost-increasing sand into the works, and as a consequence, targets become either too expensive or, more simply, unattractive.

Golden parachutes refer to separation provisions of an employment contract that compensate managers for the loss of their jobs under a change of control clause. The contractual agreements provide substantial (often millions of dollars) payments to managers who elect to,

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[186] Fällman, Anders, (1990), Motåtgärder vid företagsförvärv, Särtryck ur betänkande från ägarutredningen (SOU 1990:1) p.77
[187] Nial, H., (1998), Svensk Associationsrätt i huvuddrag"
[188] Jonsson, Tor., (1996), *"Försvarsåtgärder mot fientliga företagsförvärv"*, Juridisk Tidskrift 1996/97 p.905
[189] Fällman, Anders, (1990), *"Motåtgärder vid företagsförvärv"*, Särtryck ur betänkande från ägarutredningen (SOU 1990:1) p.78

or are forced to leave the firm when a change of control takes place. The effect of this measure is to insulate a target's management from harm even in the case of a hostile tender offer. However, the most obvious effect of golden parachutes is that they encourage managers to accept changes of control that would bring shareholder gains, and thus reduce the conflicts of interests between managers and shareholders as well as the transaction costs deriving from managerial resistance.[190]

Davidson (1985) has further argued that the golden parachute is the only way to offer job security to top management, especially considering the vast amount of takeovers that the global markets experience today.[191] In Sweden, for example, a top executive five years ago would in average stay in office for seven to eight years. Today, the average "survival" time has sunk to five years, where 50% of top executives within the manufacturing industry leave their offices already after two years.[192] In order to attract top executives to such vulnerable positions there must be some sort of bait. Thus, golden parachutes are supposed to serve three main functions. First, they attract top executives to take on exposed positions, even in takeover vulnerable corporations. Second, it is supposed that parachutes make managers less sensitive to hostile takeovers and induce them to determine more dispassionately whether or not the offer is in the best interests of the corporation. Third, they throw cost increasing sand into the machinery when a hostile bid is at the gate. Lambert and Larcker (1985) showed that the adoption of golden parachutes results in average stock price increases of about 3%.[193] However such empirical evidence does not prove whether the stock price increases are due to the beneficial use of golden parachutes *per se* or due to the market interpreting the use of the severance payments as a reflection of an increased likelihood of a hostile tender offer.[194]

Not the least in Sweden, there has been a quite intensive critique against the use of golden parachutes, especially considering the fact that such inducements are in most cases adopted by the board of directors. Some argue that golden parachutes in no way benefit shareholders and simply give managers economic advantages. Others claim that golden parachutes hinder an effective market for corporate control as poorly performing managers, due to these inducements, no longer are punished when fired. A related argument is that the increased risk of losing one's position through a takeover may induce managers to focus primarily on the

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[190] Knoeber, Charles R., (1986), *"Golden Parachutes, Shark Repellents, and Hostile Tender Offers"*, The American Economic Review, Vol.76, p.156
[191] Davidson, K.M., (1985), *"Mega-Mergers"*, Ballinger Publishing Company, Cambridge, p.63f
[192] Dagens Nyheter 000709 and De Baker & Co. Consulting
[193] Lambert, R., Larcker, D., (1985), *"Golden Parachutes, Executive Decision-Making, and Shareholder Wealth"*, Journal of Accounting and Economics, 7, April 1995, p.179ff
[194] Weston, J.F., Chung, K.S., Hoag, S.E., *"Mergers, Restructuring, and Corporate Control"*, p.490

short term or even taking exceedingly high risks. Additionally, golden parachutes have been said be good only for "first class passengers" and not for "economy class passengers", thus creating jealousy and friction within companies.

However, in a takeover context, golden parachutes have shown to be more effective as management bait rather than effective defense measures against hostile takeovers. Even though the aggregate amount paid to top executives may be substantial, the amount is usually negligible in a hostile takeover context. Therefore, companies have instead shown to establish golden parachutes not only for top management but also for middle management, so-called "tin parachutes", thus intensifying the defense by additionally increasing the cost of an unsolicited bid. In a way, such tin parachutes can have dampening effects on possible frictions and envy within a firm, however it is not clear how far down the corporate ladder severance payments can be allowed in order to be justified as being in the interests of shareholders. Beneficial Corporation, for example, awarded 200 managers with golden parachutes. Can such an action be justified from a shareholder perspective? Further, should contracts only cover those who actively are involved in negotiating and realizing corporate transfers, or should others also be included?

It is clear that the subject of golden parachutes is an area of controversy where there are always going to be parties who feel ill-treated or believe that parachutes should be completely excluded from tender offer discussions as they simply just make managers more wealthy. It is further difficult to measure the effects golden parachutes have on hostile tender offers. Even though the inducements may make shareholder's and manager's interests more aligned, there is always going to be a discussion concerning to what extent and cost a defense arsenal may be implemented in order to be morally and financially motivated. It is therefore important to have an understanding of the legal framework that regulates the limitations as well as the possibilities for provisions such as golden parachutes.

5.6.2.2 Legal Comments USA

It was during the 1980's that the US experienced a boom in the use of golden parachutes, when only in 1982 alone 1500 companies introduced such inducements.[195] Already in 1988, F. Ross Johnson, CEO of RJR Nabisco, Inc. received a golden parachute amounting to $53.8 million after the hostile takeover by Kohlberg Kravis Roberts & Co (Christensen 1991).[196] However, even though US courts have in several cases reviewed a number of golden parachutes, it is not clear to what extent golden parachutes have legal support in a takeover

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[195] Cooke, T.E., (1988), *"Mergers and Acquisitions"*, p.240f

[196] Christensen, Jan Schans., (1991) *"Contested Takeovers in Danish Law"*, note 160 p.380

context. Most court decisions concerning the severance payments have not been related to hostile takeover defenses.

Both Christensen (1991) and Davidson (1985) believe that the legality of golden parachutes should be evaluated pursuant to the "usual standards", including the business judgement rule and that rational parachutes may be beneficial to shareholders in the longer term. Others, on the other hand, have claimed that the business judgement rule in this context should be replaced by a *"reasonableness standard"* when evaluating parachutes.[197]

In 1983 the SEC formed a Tender Advisory Committee which recommended that golden parachutes should be decided upon by annual advisory votes by shareholders and that a company should not be admitted to offer managers compensation packages when a hostile bid has been launched or is imminent. Additionally, the Tax Reform Act 1984 set up two obstructions to golden parachutes, stating that "excessive" parachutes may not be deducted for corporation tax purposes and that managers are obliged to pay a 20% excise tax on excess amounts.[198] S.1323 of the Tender Offer Disclosure and Fairness Act also prohibits companies from adopting golden parachutes while a tender offer is pending. However, the legislation does nothing to deter corporations from adopting parachutes at any point in the future, as long as the paperwork is signed before the tender offer begins. Thus, the legislation is quite toothless, especially regarding all the companies that already have signed compensation plans in anticipation of takeover battles.

State law does not either give clear guidance in this matter and seems to favor incumbent management. State law allows a great deal of discretion when boards of directors decide upon compensation for their officers, and judging from the business judgement rule, courts seem to hold that parachutes and other compensation plans are valid as long as they are not patently absurd. In Buckhorn, Inc. v. Ropak Corporation the court backed golden parachutes on the basis that the parachutes had in a rational manner upheld shareholder's interests in retaining able managers in a trenchant situation without overburdening the company or entrenching the management.[199]

Conclusively, neither federal nor state law gives clear guidance to what extent golden parachutes are lawful. The control is quite toothless, where each case has to be seen in the

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[197] See for example *"Platinum Parachutes: Who's protecting the shareholder?"* Hofstra Law Review 653 (1986)
[198] Ault, H.A., *"The Impact of Tax Rules on Corporate Governance"*, Skattenytt nr.4, 1997
[199] 656 F. Supp. 209 (S.D. Ohio 1987)

light of the business judgement rule. It appears to be that golden parachutes that are established and administered pursuant to the business judgement rule will not be challenged by the courts. However, compensation plans, irrespective of size, will never be accepted as long as they are intended to entrench management and as long as they are arranged for after a hostile bid has been launched.

5.6.2.3 Legal Comments UK

The opportunity to use golden parachutes in the UK is somewhat curtailed due to the fact that section 319 of the Companies Act 1985 limits the maximum length of manager's service agreements to five years, unless otherwise has been approved by a general meeting. Moreover, the Combined Code, including the principles of good governance and the code of best practice prepared by the Committee on Corporate Governance, has contended that *"/.../there is a strong case for setting notice or contract periods at, or reducing them to, one year/.../"*, thus restricting the provisions even more.[200]

In a takeover perspective, golden parachutes are under even more restriction. The City Code prohibits the amending or entering into of service contracts, or the creating or varying of the terms of director's employment *"in such a way as would constitute an abnormal increase in the directors emoluments or a significant improvement in his terms of service"*.[201] Thus an agreement entered into specifically for the purpose of fighting off a hostile bid is unlawful, where the Panel interprets such contracts as *"otherwise than in the course of business"*.[202] Moreover, if a service agreement is entered into within one year prior to a takeover offer should be presumed until the contrary is proved, to have been entered into in contemplation of the offer and, unless ratified by the company in general meeting prior to the implementation of the takeover, should be invalid. [203] In addition, both statute, the Code and the Stock Exchange state that the details of golden parachutes have to be disclosed to all shareholders in full.[204]

5.6.2.4 Legal Comments Sweden

In Sweden a chief executive officer's employment agreement is ratified and signed by the board of directors, and the major principle is that a manager with a golden parachute may not be unduly favored by the target corporation. If a board of directors has ratified a severance payment that is in no way market-oriented it is plausible that the contract is in breach of the

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[200] Weinberg and Blank on Takeovers and Mergers, (1999), p.4193
[201] City Code on Takeovers and Mergers, Rule 21, n.6
[202] City Code on Takeovers and Mergers, Rule 21, n.6
[203] Weinberg and Blank on Takeovers and Mergers, (1999), p.4195
[204] Weinberg and Blank on Takeovers and Mergers, (1999), p.4194

equality principle of CA 8:15. In such a case there is no room for a CEO to claim that the contract is valid based on believing that it was a bona-fide offer. Further, an acquiring corporation can, after a hostile takeover, try to adjust a generous parachute based on the general clause in the §36 of the Swedish Law of Contracts, thus reducing the tender offer costs. It is further important to note that a CEO that contests a bid may act in breach of his contract, giving reason to revoke the employment contract as a whole. Such a possibility lies both in the hands of a successful acquirer as well as of an incumbent board of directors (Fällman 1991).[205]

72% of Swedish CEO's have golden parachute agreements with an average duration of at least two years.[206] However, even though there has been an intensive debate concerning the appropriateness of golden parachutes in Sweden, I have not come across any court rulings concerning severance payments in the tender offer context.[207]
Moreover, the sizes of golden parachutes in Sweden are far from what can be found in the US, thus as a defense, they will quite surely be negligible and inefficient.

5.7 Emergency Tactics

5.7.1 Introduction

Common for the emergency tactics is that they all aim for direct retaliation through the purchase of shares, either of own shares or of other outstanding shares. I have come to call these defenses emergency tactics as they are quite drastic, may be the last way out and show that companies muster every possible method they can to fend off takeover bids.

5.7.2 Pac-Man Defense

Just as in the popular video-game "Pac-Man", the thrust of the Pac-Man defense is to gobble the opponent before the opponent gobbles you. Thus, when a company is faced with a hostile bid, the target can, as a defense, launch a tender offer for the acquiring company in order to receive a sufficient amount of shares to either take over the hostile suitor or, more simply, stop the initial hostile bid. This strategy was introduced in the US in 1982, and the classic case is the four-cornered battle involving Bendix, Martin Marietta, United Technologies and Allied Corporation. In 1982, Bendix aimed to expand its business by launching a hostile bid for Martin Marietta, the aerospace contractor. Martin Marietta aggressively responded by initiating a tender offer for Bendix. Suddenly, Bendix was put on the defensive, fighting a

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[205] Fällman, Anders, (1990), *"Motåtgärder vid företagsförvärv"*, Särtryck ur betänkande från ägarutredningen (SOU 1990:1), p.79
[206] Dagens Nyheter 000709
[207] As an example of the debate, see the conflicts concerning the golden parachute of Göran Lövgren, former CEO of BPA.

two-front war as United Technologies had launched a competing bid for Bendix. The outcome was that Bendix, the initial raider, had to set up a crown-jewel defense, selling sixteen cement plants and its Sodyeco Division, as well as it had to call for and be rescued by a white knight, Allied Corporation. Further, as an interesting note, fifteen banks where involved with at least two of the four companies, and three banks were involved with three or more of the four companies.[208]

Thus, the aim of the Pac-Man defense is to acquire a large enough stake in the hostile suitor, preferably 50% of the voting rights, in order to be able to exert influence and have operational control over the hostile suitor. The parties virtually race to acquire control of each other, each party aiming at acquiring enough shares of the other that would give the party sufficient control of the other company to be able to effectuate a decision to cease further share purchases. Further, the defense aims at disabling the initial bidder by accumulating so much debt that a takeover would mean loosing considerable value.

A Pac-Man defense can be fulfilled either through a so-called "counter tender offer" or through a "counter accumulation". A counter tender offer implies that the target officially launches a tender offer for the bidder, whereas in a counter accumulation the target buys the bidder's outstanding shares on the open market. The counter tender offer is often faster, however the counter accumulation has turned out to be cheaper.
Worthwhile mentioning is also that a Pac-Man defense often results in that other bidders enter the bidding arena.

The Pac-Man defense is surely one of the most bizarre methods to achieve corporate control. It is rarely used as it requires a substantial cash investment by the target corporation as well as the outcome is difficult to determine in beforehand.

5.7.2.1 Legal Comments USA

The legal point of departure when evaluating the legality of a Pac-Man defense in US federal law is to see if the board has acted in good faith and in furtherance of what is seen as a "good corporate purpose" according to the good corporate purpose test of the Williams Act. Further, SEC rule 14(e) underlines the importance of a board's fiduciary duties owed to its shareholders, prohibiting any fraudulent or manipulative acts or practices in connection with a tender offer. The problem in this sense is that the initial bidder is, when the counter offer is launched, a shareholder in the target, causing uncertainty concerning whether a counter bid

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[208] Cooke, T.E., (1988), *"Mergers and Acquisitions"*, p.239f

towards a shareholder is to be regarded as a fraudulent or manipulative act, breaching any fiduciary duties.[209]

For the sake of legality it is also important to distinguish the two different methods of setting up a Pac-Man defense. If the target launches a counter accumulation it has the advantage that it has not legally bound itself to an official offer, thus escaping offer timeline regulations. A counter tender offer, on the other hand, has to follow the SEC's regulations on such bids.

As I mentioned earlier, the thrust of a Pac-Man defense is to reach a large enough stake in the initial bidder in order to be capable of calling for a general meeting and change the board of directors. However, it is state law that regulates shareholders possibilities to call for a general meeting, where regulations can vary greatly between states. Thus, as was shown in the Martin Marietta case, being incorporated in a state with less stringent rules can turn out to be quite disadvantageous. In the above referred to case it turned out to be decisive that Martin Marietta and Bendix were incorporated in two different states. Under Maryland law, where Martin Marietta was incorporated, the corporate statute provides that the changing of a board of directors has to be done at a shareholder meeting, and a ten day's notice has to be given before such a meeting can be held. However, under Delaware law, where Bendix was incorporated, an acquirer who has reached a majority of holding of shares can exert his influence instantly. In this case, the different state corporate statutes made it possible for Martin Marietta to exert its influence over Bendix, before Bendix could do so with respect to Martin Marietta. The Delaware court found Martin Marietta's actions in good faith and for a good corporate purpose.[210]

Finally, the SEC has also stated that tender offers for an initial offeror's shares is an appropriate defensive action where the target tacitly recognizes that a combination between itself and the bidding company is appropriate. On the other hand, the SEC does not see that a company properly protects the interests of its shareholders if *"the offer is for all target company shares, there being, in such circumstances, no remaining shareholders to protect. The recommendation, therefore, is for prohibition of counter tender offers if 100 percent of shares is sought and the offer consideration is cash."*[211]

[209] Hazen, T.L., (1994) *"The Law of Securities Regulation*", p.384
[210] Cooke, T.E., (1988) *"Mergers and Acquisitions"*, p.240
[211] Ffrench, H.L., (1986), *"International Law of Take-overs and Mergers"*, p.159

5.7.2.2 Legal Comments UK
As for the Pac-Man defense in the UK I have not found any cases or any literature applicable to such a defense. Cooke (1988) has shortly just stated that such a defense is not legally possible in the UK due to the fact that it is in breach of General Principle 7 and Rule 21.[212] My interpretation is that the Takeover Panel has the notion that the actions specified in Rule 21 are solely examples of conduct disallowed by General Principle 7 and do no bind the magnitude of the principle, which extends to any action which could result in the shareholders being denied the opportunity to decide the outcome of a bid. Thus, the Pac-Man defense, even though it is not expressly stipulated for in the prohibition, is most surely not in the best interest of shareholders and therefore illegal. Naturally, there may be exemptions to such a prediction, depending on each specific case.

5.7.2.3 Legal Comments Sweden
As of February 2000 it has become lawful for a Swedish corporation to purchase its own shares. Before the amendment the Pac-Man defense was quite an effective defense mechanism because as soon as one of the contestants reached a majority in the opposing corporation, the latter was hindered to acquire additional shares as the two corporations were seen to be the same legal entity. However, such a restriction no longer exists. The race should therefore resemble what is found in the US.

Moreover, important to note is that NBK's takeover recommendations naturally also have to be followed. Sections II.3-4 state that the period of acceptance of an offer must be at least three weeks and may not commence prior to publication of an offering memorandum. Further, if the acquirer has stipulated terms, which he has reserved the unilateral right to exercise, as a condition for the implementation of the offer, shareholders have a right to withdraw their acceptances within at least three weeks. During this period the target corporation can purchase the initial bidders shares on the open market, making it possible to reach a practical voting majority, 1/10 of all shares, and thus call for a general meeting aiming at stopping the initial bid (CA 9:6). Naturally the ownership structure in the bidder can have a decisive effect on the outcome of such a strategy. If the bidder has a controlled ownership structure (CS) or a controlling minority structure (CMS) the Pac-Man defense will be difficult to exert.

I have not come across any attempts to a Pac-Man defense in Sweden, however in the hostile battle between Kanthal AB and Höganäs AB a resemblance to the defense can be seen. When Kanthal launched a hostile bid for Hallstahammar AB, which was partly owned by Höganäs,

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[212] Cooke, T.E., (1988), *"Mergers and Acquisitions"*, p.244

the latter retaliated by purchasing Kanthal shares from Custos AB. It thus turned out to be an indirect Pac-Man defense.

5.7.3 Leveraged Buy-Outs and Management Buy-Outs

5.7.3.1 Introduction

In section three I illustrated how leveraged buy-outs (LBO's) and management buy-outs (MBO's) can be effective tender offer strategies, however, it is a fact that these two phenomenon have also proven to be effective defense mechanisms in a hostile takeover context. In order to illumine the reader, in short, a LBO is a corporate acquisition in which a large part of the purchase price is debt-financed and where the remaining equity is privately held by a small group of investors. The MBO is principally completed in the same manner as the LBO, however, in stead of a small group of external investors, the acquiring group is lead by the target's own management. Thus, the LBO and MBO usually entails "going private", an expression that some authors have preferred to use.

LBO's and MBO's differ from for example lock-up agreements in the sense that the aim is not to make the target unattractive, the goal is, just like the Pac-Man defense, to actively compete the raider on the market for corporate control. Rather than responding in a strictly defensive fashion, management thus attempts to eliminate an aggressor by acquiring an equity stake in the own target company. Moreover, the fact that managers can win a bidding war for the target suggests that the profits from an acquisition can be obtained by them as well as from outside bidders. It is further likely that a MBO will lead to that mangers will rearrange the target's assets for more effective use especially as managers may have been unwilling to implement such changes before having been forced to make a defensive bid for the firm at a large premium.

The first step in a MBO is the setting up of a so-called acquisition vehicle, a newly formed legal entity. The target management usually owns the shares in the acquisition vehicle, however it is quite common that other investors are invited to acquire equity holdings in the new company. Nevertheless, management will still stay in control of the acquisition vehicle through the use of dual-class stock, giving management the high-vote shares. The second step in a MBO is commenced when the acquisition vehicle acquires the shares of the target corporation, where after the target is effectively de-listed from the stock exchanges and "goes private".[213] Without any tradable outstanding shares, the risk of a hostile takeover has thus been eliminated and full control is in the hands of the new owners.

[213] Christensen, Jan Schans, (1991), *"Contested Takeovers in Danish Law"*, p.373f

After the completion of a MBO managers are given a greater stake in the business through their direct ownership of shares or through stock options. The conflict of interest between the owners and the decision-makers will thus be narrowed down as the agency costs are practically abolished where private investors will closely monitor management performance and act right away if something goes awry. However, the private ownership is usually not intended to be permanent. The most successful MBO's go public again as soon as debt has been paid down. The requirement to generate cash for debt service is designed to curb wasteful investments, improve operating efficiency and thus prove to the market that the target can ultimately stand on its own feet.[214]

Proceeding with a buyout is in no way free of risk. First of all the process calls for additional bidders as the company receives a price tag and is "put into play". Secondly, there is quite a large risk for insolvency as the targets become very heavily debt-burdened and have shown to have equity/asset ratios in the lows of 1/6 and 1/12.[215] The risk for insolvency is additionally propelled by the fact that most of the companies that go through buyouts are often in-diversified, thus being very sensitive to market volatility. Other factors such as that managers tend to focus more on the debt than on strategy naturally also add to the negative side of buy-outs.

However, irrespective of the high risks involved, and irrespective of the fact that they carry premiums of 30% to 50 % over existing prices, MBO's and LBO's have proven to be increasingly popular during the past decade.[216]

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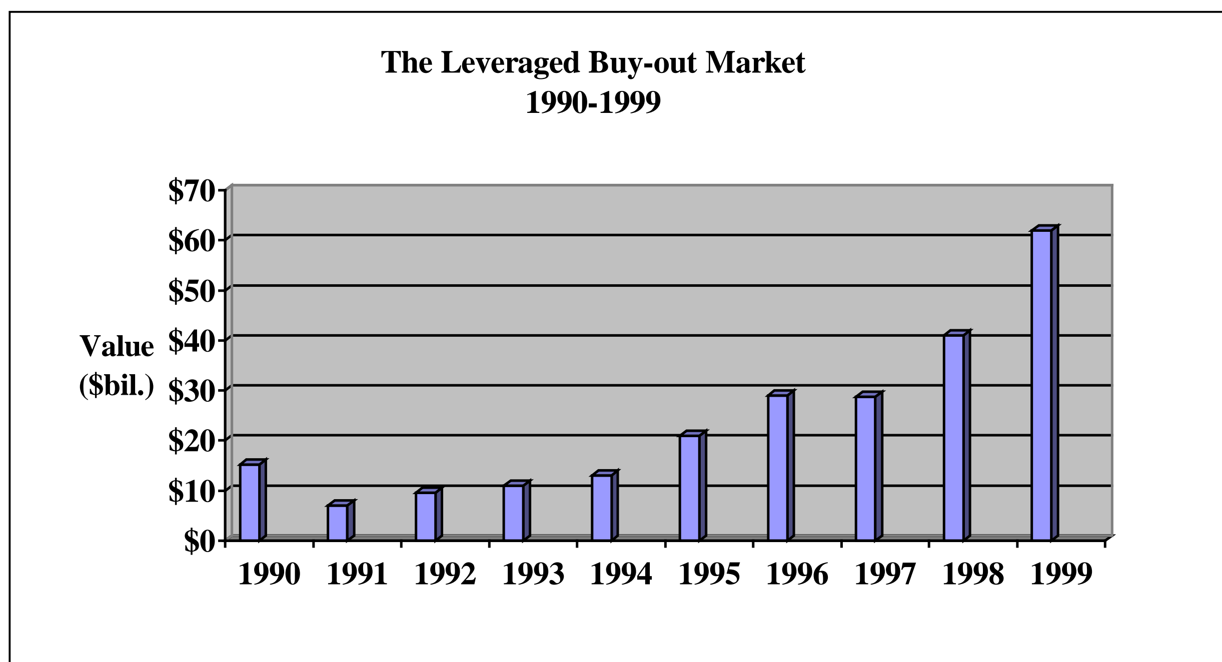
[214] Brealey, R.A., Myers, S.C., (2000), *"Principles of Corporate Finance"*, p.977ff
[215] Auerbach, A.J., (1988), *"Mergers and Acquisitions"*, p.87
[216] Easterbrook, F.H., Fischel, D.R., (1996), *"The Economic Structure of Corporate Law"*, p.139

Table 11: The Leveraged Buy-out market 1990-1999



Source: Mergers & Acquisitions, February 2000

5.7.3.2 Legal Comments USA

The legal discussion concerning the use of buyouts as a defense in the US has primarily focused on the intrinsic conflict of interests which accompanies the phenomenon. On the one hand there is management's duty to act in the best interests of shareholders. On the other hand, there are the concerns of management who have a self-interest in their acquisition, an interest which is no different from any other corporate investor. Moreover, management alone possesses inside information which can be used to directly influence share price, giving management the advantage of being able to time their move in a way that ensures top-notch personal financial outcome.

From this background, opinions differ whether or not the business judgment rule should apply when evaluating management decisions to proceed with management buy-outs. Michel et al. (1986) believes that the business judgement rule should be used in these conditions,[217] however the Corporation Acts of California, Delaware, New York and Illinois, amongst others, have proven not to support their standpoint.[218]

Instead of the business judgement rule, the above mentioned states, foremost Delaware, use a test, a so-called *"liberalized appraisal method"* in order to evaluate if management has made

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[217] Michel, A., Shaked, I., (1986), *"Takeover Madness"*, p.129f

[218] Ebke, Werner F., (1992), *"The Regulation of Management Buyouts in American Law: A European Perspective"*, p.301

a "fair deal" and if the interests of shareholders have been taken into account.[219] The fairness test sees to how a buyout was initiated and at what point in time, how it was structured, negotiated, disclosed and how the approvals of shareholders and directors were attained. Further, when evaluating the fairness of the price paid for the shares, the courts have approved *"any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."*[220] Additionally, according to the Delaware courts, it is the individuals who stand *"on both sides of a transaction"* i.e. management, that have the burden of proving the fairness of an MBO.[221]

The "fair", "fair and reasonable" and "just and reasonable" provisions found in many of the states corporation acts can also be identified in section 8.31 of the Revised Model Business Corporation Act prepared by the Committee on Corporate Laws of the American Bar Association.[222] According to the Act, MBO's and LBO's are fair if they are within the range that may have been entered into an arms-length by disinterested persons. Thus, *"the fairness of a transaction is evaluated on the basis of the facts and circumstances as they are known or should have been known at the time the transaction was entered into or at the time it was approved by the board of directors, a committee or the shareholders."*[223]

Conclusively, it is a fact that the US has faced a gradual relaxation of the corporations laws, as well as of the enabling tax laws and accounting rules, greatly contributing to a wider use of MBO's and LBO's on the American financial markets.[224] In the present discussion in legal as well as economic gatherings, market-oriented concepts of valuation as well as disclosure requirements are acknowledged methods of protecting shareholders in MBOs. The weight of fulfilling the goal of fair treatment rests upon the shoulders of the courts. The courts have by and large shown to be successful in protecting the interests of shareholders, however flaws have shown to appear in the protection of employees, bondholders and consumers.

5.7.3.3 Legal Comments UK

In the UK, LBO's and MBO's grew popular during the early 1980's, where only in between 1980-89 over 2500 MBO's faced the UK financial markets.[225] Already in October 2000 the total value of UK buyouts eclipsed the £16.9 billion record set in 1999 with an average deal

[219] See for example Weinberger v. UOP, Inc., 457 A.2d 701 (Del.Sup.1983) and Susman v. Lincoln American Corp., 578 F.Supp. 1041 (N.D.Ill.1984)
[220] Weinberger v. UOP, Inc., 457 A.2d 701 (Del.Sup.1983)
[221] Christensen, Jan Schans, (1991), *"Contested Takeovers in Danish Law"*, p.374
[222] Henn, H.G., (1984), *"Laws of Corporations"*, p.8
[223] Ebke, Werner F., (1992), *"The Regulation of Management Buyouts in American Law: A European Perspective"*, p.301
[224] The market for LBOs grew from $1 billion in 1980 to $40 billion in 1986 Ebke p.298
[225] Begg, P.F.C., (1991), *"Corporate Acquisitions and Mergers"*, p.14.1

value of £41.1 million.[226] The number of buy-outs in response to hostile bids is however unclear.

Although the margin for permitted post-bid defensive actions in the UK is significantly narrowed by the City Code on Takeovers, the management buyout can be an effective way to circumvent certain City Code restrictions. As I have mentioned earlier, UK takeover regulation excludes any possibilities of partial bids as the provisions of the mandatory offer state that a takeover attempt that lacks adequate financial support to acquire 100% of a target's shares is seen as unlawful. Thus, when faced with a hostile bid, a management can, as long as it has financial support, launch a competing bid in the form of a management buyout in order to inflate the target share price. The thrust of such an action is to lead the hostile bidder into considerations of whether he can fulfill the mandatory provisions of the City Code even at a higher share price. Thus, as the management buyout group will be considered as acting in concert and will be subject to the provisions of the City Code regarding the mandatory offer and the highest price paid, the initial hostile bidder is, according to rule 6 of the City Code, obliged to raise his bid to the amount of the price paid by the competitor. In such a manner the target board can inflate the price of their stock and increase the amount of the "highest price" which the hostile bidder is obliged to offer, thus substantially raising the cost of the mandatory offer and occasionally even rendering it disadvantageous. Additionally as an interesting note, a competing bid announced in the UK while an existing offer is open for acceptance, implies that the first bidder becomes subject to the second bidder's timetable. Thus, as a MBO in the face of a takeover is seen as a competing offer, the last day by which a bidder needs to satisfy the acceptance condition will therefore be the same date for both bidders, creating additional uncertainty and cost for the initial bidder.

Naturally there are also backsides to management buyouts that have to be taken into consideration. Firstly it is important that the financial supporters of a MBO can ensure that the offer is not capable of being declared unconditional due to the lack of capital when the mandatory acquisition provisions of the Companies Act are brought into force.[227] Secondly rule 20.2 of the City Code stresses the fact that any information given to one offeror, including themselves, has to on request be submitted equally and promptly to any other competing bidder. The provision further states that *"the directors of the offeree company who are involved in making the offer [will] co-operate with the independent directors of the offeree company and its advisers in the assembly of this information"*.[228] Thus, the fact that

[226] Centre for Management Buy-out research, Nottingham, October 8, 2000
[227] Weinberg and Blank on Takeovers and Mergers, (1999), p.2084
[228] Weinberg and Blank on Takeovers and Mergers, (1999), p.2087

managers wish to proceed with a MBO and enhance the image of the company by disclosing additional information convinces shareholders that the real value of their stock is higher than the one reflected in the public market, raising justified criticism against the board for suppressing the stock price and keeping the shareholders ignorant to the true value of their stock. In such a perspective, incumbent management retrospectively admits that it has breached its fiduciary duty to maximize shareholder value. Additionally the Code stresses the importance and the sensitivity of any disclosure relevant to the stock price of a company, especially after it has become target of a takeover bid. Consequently, any disclosure after the thirty-ninth day beyond the posting of the offer document is prohibited.[229]

It is not unusual that managers, at the same time as they pursue a MBO, encourage others to increase the demand for the target shares, and as the Takeover Panel emphasizes the importance of protecting shareholders and maximizing their value, the Panel has shown tolerance in appraising such group purchases on the open market. The Panel has proved to judge their contemporary purchases as not acting in concert as their motives may have been such as their will to support the board's commercial policy or even their personal friendship with employees, without considering the acquisition of control of the company through the aggregation of their shareholdings with the ones held by the directors.[230]

Conclusively, management buyouts as a response to hostile bids are lawful as long as they are pursued within the legal framework of the City Code and the Companies Act and as long as the principle of maximizing shareholder value is acknowledged. There is a latent conflict of interests and a problem concerning the disclosure of information, however through the obligation to seek unbiased financial valuation as well as advise, shareholders are given the possibility to vend their shares at a fair price. Contemporary legislation and the Takeover Panel further aim at making sure that the competing bids are equally regulated on the market for corporate control.

5.7.3.4 Legal Comments Sweden

In Sweden buy-outs are regulated under a dual regime of statutory provisions and recommendations, where the intensity of the interaction depends on the type of buyout. In the case of a management buyout it is mainly The Stockholm Stock Exchange Recommendations Concerning Buyouts of Businesses or Shares From Stock Market Companies, Etc (1991), The Companies Act and the Act Concerning Directed Share Issues in Stock Market Companies,

[229] Weinberg and Blank on Takeovers and Mergers, (1999) p.2087f
[230] Begg, P.F.C., (1991), *"Corporate Acquisitions and Mergers"*, p.14.1-14.13

Etc (1987:464, (Lex Leo[231])) that apply. The Recommendation goes further than the law in several respects, however in situations where the Recommendation involves statutorily regulated areas, the Recommendation must give way for the law, at least when the latter imposes stricter requirements than the Recommendation.

The purpose of the Recommendation is to reduce the risk of a management exploiting its position in the company, especially regarding to its access to information and possibility to set the price of the firm too low. The Recommendation thus prescribes the forms for decision-making and relevant information requirements. However, very important to note is that the Recommendation only covers the "acquisition by senior executives of shares in a company in the Company's corporate group or a business within the corporate group, where the Buyout is of not insignificant importance for the position and financial results of the Company". Thus, buyouts by senior executives or other investors of shares in a stock market company by means of a *public offer* are not covered by the Recommendation. In such cases NBK's Recommendation Concerning Public Offers for the Acquisition of Shares (1999).

Firstly, the Buyout Recommendation states that a management buyout, which is not by means of a public offer must be approved by a general meeting. *"The general meeting's decision in this context comprises the view which has received more than half the votes cast, unless otherwise stated in the articles of association or by the Act Concerning Directed Share Issues in Stock Market Companies, Etc (1987:464)."*[232] Thus, in a hostile situation the MBO has a quite significantly restrained with reference to the fact that shareholder approval is, unless otherwise stated, necessary. Moreover, Item 4. of the Recommendation states that the board of the target company must obtain an objective valuation of the company by an independent expert, and the statement must be available to the shareholders in the company for timeframe of at least two weeks prior to the general meeting. This time limit extends beyond the provisions under the Companies Act as regards to proposals for decisions at general meetings on stock offering. Further the CA indicates how the board shall proceed if disclosure of this information might result in material prejudice for the company. As I have mentioned earlier, the thrust of post-bid defenses is to act rapidly within the framework of legality. The two-week timeframe stipulated in the Recommendation effectively hinders such swift management action, causing parallelism in the face of an unsolicited bid.

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[231] *(Lag (1987:464) om vissa riktade emissioner i aktiemarknadsbolag m.m.)*
[232] The Stockholm Stock Exchange Recommendations Concerning Buyouts of Businesses or Shares From Stock Market Companies, Etc (1991), Item 3

5.8 Target Litigation

5.8.1 "Showstoppers" and "Anti-trust Defense"

A common response to a hostile takeover, especially in the US, is to file an anti-trust or other lawsuit against a bidder, and irrespective of whether or not the litigation is justified, the judicial process is sure to give the target breathing room. Such defenses are known as "showstoppers" or "anti-trust defenses" and as soon as time has been bought, the target can seek other defensive measures. Litigation only impedes takeovers in very few situations, however the means of defense is in most cases accompanied by other and more efficient anti-takeover measures. Further, even though there are limitations of fiduciary duties, managers can try to make the target unattractive by deliberately creating possible liability under applicable takeover regulations.

5.8.2 Legal Comments USA

A majority of the unsolicited bids in the US are confronted with delaying litigation where targets seek to obtain injunctive relief arguing that the takeover violates state tender offer statutes, state securities laws, margin requirements, the Investment Company Act, anti-trust laws, the Williams Act or other pertinent takeover regulation. More than one third of all targets listed on the NYSE and the AMEX have taken advantage of such a defense.[233] The underlying strategy in most of the showstoppers is quite straightforward, where the target will try to raise as many legal issues in state and federal courts as well as regulatory agencies as possible. Even if the target only prevails in one of the legal issues, it can win the preliminary injunction necessary to render the time to set up a more effective defense arsenal.

Moreover, showstoppers in the form of litigation have shown to be in line with manager's duties to maximize shareholder wealth. While there is some risk that litigation may cause shareholders to miss the opportunity to tender their shares to the only suitor in town, the goal in most cases is to increase the share price either from the initial bidder or from additional competing bidders who enter the arena during the interim.[234]

Showstoppers in the form of anti-trust cases have shown to be quite common and effective, where targets have acquired interests in other companies deliberately making themselves too big for a takeover, a so-called "fatman defense". In this sense the major anti-trust rules behind which a target can hide are the Clayton Act and the Sherman Act.[235] Section 7 of the Clayton Act will block a takeover if it reduces competition or creates a monopoly, whilst the Sherman

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[233] Weston, J.F., Chung, K.S., Hoag, S.E., (1990) *"Mergers, Restructuring, and Corporate Control"*, p.521

[234] Weston, J.F., Chung, K.S., Hoag, S.E., (1990) *"Mergers, Restructuring, and Corporate Control"*, p.521

Act forbids business combinations that hinder interstate commerce or foreign trade. Important to note, however, is that there are naturally also limitations to the use of a "fatman" defense, as even here the business judgement rule applies. If the target management cannot convince a court that their defensive merger was in the best interest of shareholders and was not merely motivated by opposition of the hostile offer, then such a defense will most likely fail.[236]

In addition to anti-trust regulations, targets have also been seen to call for breaches of the disclosure requirements in the Williams Act. Schedule 14(d)(1) specifies that a corporate bidder must disclose the purpose of the offer, how the offer is to be financed, prior contacts with management, the impact of regulatory requirements and unreported misconduct. These requirements have been pointed out to be general areas of potential violations that have created favorable grounds on which disclosure violations have been charged.[237] Even though disclosure violations are quite easily corrected, several such breaches can win effective delays. Moreover, a target can call for a preliminary injunction if it can show that there is a probability that it will succeed on the merits of his cause of action and that there is a probability that it will suffer irreparable harm if the relief is not granted.[238] A preliminary injunction will stop a bidder from taking any further action in the tender offer process, and even if such a lawsuit does not render to the point where preliminary injunction is sought, the target will once again here be given additional breathing room.

Obviously showstoppers are quite toothless in the sense that they seldom fully block hostile tender offers. However, they are very effective in delaying acquirers in their bidding process and provide targets with the vital gains in time that they may need in order to set up an effective defense. The aspect of surprise in hostile takeovers is thus quite effectively crippled.

5.8.3 Legal Comments UK

Unlike in the US where litigation usually is the first line of defense, UK targets have only in a few cases shown to be willing to turn their way to the courts as a measure of defense. Already in the 1970's the Takeover Panel made it quite clear that it did not honor the use of courts in defending a hostile bid and underlined that an offer should be determined by the target's shareholders. In a Panel Statement of January 18, 1977 it was pronounced that:

"/…/if the board of an offeree company contemplates legal proceedings in relation to an offer or prospective offer, problems may in certain circumstances arise under the Code. The board

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[235] Boesky Ivan F., (1985), *"Merger Mania"*, p.124
[236] Hazen, T.L., (1995), *"The Law of Securities Regulation"*, p.381
[237] Boesky Ivan F., (1985), *"Merger Mania"*, p.122
[238] Ffrench, H.L., (1986), International Law of Take-overs and Mergers, p.98f

would therefore be well advised in such a case to consult the Panel before any action is taken."

Over time the Panel has withheld its attitude and in May 1989, in relation to Minorco's hostile bid for Consolidated Goldfields plc, the Panel lay down an even more restrictive attitude to the use of target litigation. The Panel stated:
"Litigation could become a tactical weapon intended to prevent a bid from being considered on its merits. All this could take place regardless of the views of shareholders who own the company. We think that, in principle, this would be highly undesirable and potentially gravely damaging to the orderly conduct of bids/.../Shareholders should be entitled whether such actions should take place/.../General Principle 7 is one of the most important in the Code. It prevents action taken by directors which may bring the interests of managers into conflict with those of shareholders. It is an important element in securing that shareholders be given the opportunity to consider a bid for their company/.../."[239]

The above statement gives the impression that the Panel will not accept any litigation that does not have shareholder approval. Further, the statement gives the impression that the Panel makes no distinction between on the one hand litigation that is brought up as a *defense* tactic and on the other hand litigation that it brought to the courts because the target believes that there is a *wrong doing* from the bidders side. However, the case is not so. Shareholder approval is not necessary with respect to litigation that *cannot* have a frustrating effect. What the Panel seems to attack is the bringing of litigation *after* a bid has reached a mature stage and *after* shareholders have access to all relevant facts. Were the stance to be so that shareholder approval was necessary in all circumstances, litigation *would never* be a feasible course of action.[240]

In this discussion it is however important to distinguish on the one hand claims brought forth the Panel and the national courts and on the other hand claims brought forth the Office of Fair Trading. When a target believes that an offer, if closed, would damage competition or in any other way be to the detriment of the national interest the stance of the Panel does not effect the possibility to approach the Office of Fair Trading and the Mergers Commission. [241] Further, lobbying for the Office of Fair Trading and the Mergers Commission is not seen as contravening General Principle 7 as *"/.../it is not a very direct way of obstructing the offer*

[239] Weinberg and Blank on Takeovers and Mergers, (1999), p.4208
[240] Weinberg and Blank on Takeovers and Mergers, (1999), p.4208
[241] Weinberg and Blank on Takeovers and Mergers, (1999), p.4209ff

and /.../irrespective of its effectiveness the lobbying of politicians is a democratic right which it would be inappropriate for the Panel to inhibit."[242]

Consequently, there is nothing to stop a target management from claiming to the Office of Fair Trading, which in its turn refers the issue to the Monopolies and Mergers Commission, that an offer, if completed, would infringe either competition or any other public interest. If the Commission and the Secretary of State gives clearance to the target's claim, the Code prohibits a new offering within the proceeding 12 months. Furthermore, even if clearance is not honored, the target is at least, just like in the US, given additional breathing room to set up alternative defenses, especially as such investigations can take up to six months.[243]

Finally, as to the "fatman" defense, targets in the UK do have a possibility to under special circumstances merge with one or more somewhat smaller corporations in order to form an entity too large for a giant bidder to acquire without being hindered by the Monopolies and Mergers Commission. In the UK this is referred to as *"Monopolies Commission brinkmanship"*.[244] It is however important that such a merger does not breach General Principle 7 and render shareholders paralyzed as to what is in the best interest of the company.

5.8.4 Legal Comments Sweden

A Swedish company that is faced with a hostile bid can appeal to the Office of the Competition Ombudsman (Näringsfrihetsombudsmannen, NO) and claim that the takeover would give the remaining entity a dominant market position. According to Article 6 of the Swedish Competition Act, it is the Market Court (marknadsdomstolen) that can hinder a takeover due to market dominance, where the Competition Ombudsman makes such an appeal. However before the takeover is completely blocked the Market Court will usually grant a preliminary injunction, and if such an injunction is made prior to the last date of shareholder acceptances, there is a great risk that the tender offer as a whole will fail. Moreover, according to Item 6.2 of the Competition Act, the Market Court may not prohibit shares that have been bought on the open market, instead it will force the acquirer to tender the shares back onto the stock-exchange, thus decreasing the bidders stake. It is also important to acknowledge in this context NBK's Recommendation Concerning Public Offers for the Acquisition of Shares (1999). In Item II.3 of the Recommendation it is instituted that the acceptance period stated in the prospectus may only be extended if the buyer has reserved

[242] Statement by the Panel February 1989 in its ruling of B.A.T. Industries plc
[243] Weinberg and Blank on Takeovers and Mergers, (1999), p.4213
[244] Weinberg and Blank on Takeovers and Mergers, (1999), p.4182

such a right or if payment to those who have already accepted the offer is not delayed as a result of such an extension. Postponement of payment calls for a special proviso in the prospectus, and if such reservations have been declared for, the buyer is also, according to Item II.4, obliged to state that shareholders have the right to withdraw their acceptances. Thus as many tender offer prospectuses in Sweden have reservations in case of anti-trust litigation and in the light of the fact that shareholders under such conditions have a right to withdraw their acceptances and bidders are obliged to re-tender their shares, preliminary injunctions in Sweden can be very effective when defending oneself against a hostile takeover.[245] AB Volvo's initial hostile bid for Scania AB included a condition related to regulatory approvals. The takeover was investigated for many months by Swedish as well as European authorities, forcing Volvo to additionally extend the acceptance period. The Scania shareholders that already had accepted the offer were thus still free to withdraw their acceptances, creating great uncertainty on Volvo's behalf. In the end, based on anti-trust grounds, the case was stopped by Mario Monti's competition commission.

Moreover, in Sweden there are certain specially authorized industries that need extended regulation, for example banking, insurance and finance. Targets can in this sense make themselves more difficult to acquire if they can assure that they fall within such provisions. Thus, when faced with a hostile bid a target can through litigation make the Financial Supervisory Authority aware of that the acquirer is not suited for the authorized industry, and thus hinder a takeover. It is however doubtful whether such a course of action is in practice an effective anti-takeover defense.[246]

Conclusively I dare to say that target litigation with respect to anti-trust lawsuits and temporary injunctions is one of the most effective anti-takeover measures that a Swedish target can come to use.

[245] Fällman, Anders., (1990), *"Motåtgärder vid företagsförvärv"*, Särtryck ur betänkande från ägarutredningen (SOU 1990:1), p.83f
[246] Fällman, Anders., (1990), *"Motåtgärder vid företagsförvärv"*, Särtryck ur betänkande från ägarutredningen (SOU 1990:1), p.84

6. Conclusion

It is quite clear that the current attention to the takeover phenomenon is nothing new and unique. All through the 21st century numerous merger waves have ebbed and flowed, some greater some smaller. Attempts have been made trying to explain the causes and consequences of these takeover waves, however theories explaining one have failed to explain another. Moreover, although a vast majority of historical takeovers have been linked to US corporations, it is in no way excessive to state that Europe has in recent years sprung as a competitive market. The value of corporate Europe is vast and having been protected from takeovers for decades by legal and cultural traditions, which have not always placed maximizing shareholder value over all other considerations, is by all means mature for consolidation. Furthermore, Sweden with a very strong industrial tradition has also proven to be playing on the global arena, where AB Volvo's current takeover of French RVI/Mack and OM's hostile bid for the LSE, the heart of financial Europe, strongly supports such a claim.

The 1990's have been called the era of strategic mergers. Powerful change forces have transformed the economic and financial environments. Global markets and exploding technologies have blurred industry boundaries and intensified competition. Strong economic growth and rising stock markets have rewarded the leaders and penalized the laggards. These pressures have forced companies to pursue mergers, acquisitions and restructuring in the effort to achieve profitable growth.

The current wave of corporate takeovers has intensified the debate over their social desirability. On one side of the fence stand those who argue that takeovers serve two important functions: First, they allow acquiring firms to generate economies of scale or scope, apply superior knowledge or skills, or otherwise create a value-improving synergy. Second, the very threat of a takeover disciplines entrenched management, serving them notice that they are liable to be ousted if they do not act in the best interests of their shareholders. Those less enthusiastic about takeovers have raised a number of counterpoints. One line of argument infers that the takeover threat forces management to solely focus on the short-term strategy of the corporation, rather than on the long-term objective, which in the long run in no way maximizes shareholder value. Closely linked to this is further the controversy concerning the use of defense mechanisms in the face of a hostile takeover. Proponents of defensive strategies sustain that they increase the ability for target management to extract a higher price for the target's shares. Opponents, on the other hand, infer that such strategies reduce the probability of a takeover and that shareholders are worse of overall.

The introduction of the institution of investor's limited liability in combination with the separation of ownership and control, as a dominant characteristic of the modern corporation, has indulged the amassment of financial resources and has led to the creation of massive conglomerates with powerful capabilities of exerting influence on the contemporary market for corporate control. However, the very fact that the owners of today's corporation infrequently are the same as the individuals who run and make the most important decisions concerning it's future, has given rise to problems concerning the way in which managerial behavior effectively should be controlled and disciplined. It is a fact that, within the takeover context, the corporation faces one of the most intense conflicts of interest represented in it: a conflict between the director's and their interest to perpetuate their presence in office and the shareholders and their interest to maximize their wealth. There are no clear guidelines for counterpoise, however within the regulatory bodies there is a consensus that neither an unconditional promotion nor a complete curtailment of manager's duties seems appropriate, where various solutions can be found in the US, the UK and Sweden respectively.

It has become quite clear that the US form of takeover regulation primarily aims at equipping shareholders with the right of full disclosure in the event of radical changes in control over their corporation as well as sufficient time to reflect over the information as to able them to take coercive-free exit/voice decisions. However, the terms of the Williams Act, which are to serve the shareholders, are only bound to the stipulated 20-day offer period. The US takeover reasoning thus builds on the efficient capital market hypothesis, with the rationale that within a market, in which freedom of choice is safeguarded by the principle of full disclosure, market forces will lead to the most efficient allocation of wealth. Thus, the Williams Act does not effectively challenge or exclude the making of, for example, a two-tier coercive takeover after the expiration of the 20-day period, resulting in unfair effects on remaining shareholders. Furthermore, the Williams Act does not provoke the actual existence of a coercive "prisoners dilemma" in the minds of shareholders when deciding whether or not to tender their shares in relation to the choice of the other shareholders.

The UK model, on the other hand, not only furnishes for full disclosure and ample time to reach a well balanced decision, but also vigorously acts for the conservation of shareholder equality and protection. Its primary pragmatic consequence is that the possibility of a two-tier coercive merger, for example, which freezes out any minority shareholders, is most effectively limited. The reason for this is that the mandatory offer provisions effectively dishearten any takeover undertaking that is not capable of acquiring 100 percent of the target's tendered shares at the highest price offered during the preceding year. Such a

viewpoint obviously discourages any takeover attempt which, for lack of efficient financing in the first stage, would be set up in order to freeze-out remaining minorities.

Sweden, just like the UK, has enacted a self-regulatory system for takeovers. Even though there is a comprehensive statutory merger procedure in the Companies Act, which covers almost any compromise or arrangement between a corporation and its members or creditors, and although the schemes of arrangement in the Companies Act are not uncommon when effecting a change of control, the takeover bid has proven to be more effective and much more commonly used. The statutory provisions have thus in a way outlived their role, where the alternative and more detailed self-regulatory system has incorporated the basic features of the London City Code on Takeovers and Mergers. Moreover, as for the protection of minority shareholders, the Swedish mandatory bid provision creates a security much alike what is found in the UK. There is however one important distinction that has to be highlighted. In the UK, most large companies are publicly quoted where the share ownership is very widely dispersed. As a result, the UK has an "arm's length" system of ownership and control, where the typology implies that shareholders tend to maintain their distance and give executives a free hand to manage. In such circumstances, the protection of shareholders, especially minority shareholders, is extra important as no effective monitoring of managerial behavior is exerted. Thus, as ownership in Sweden is most often in the hands of large institutional investors, the mandatory bid provision, though very important, does not play as much of a dominant role in Sweden as it does in the UK.

When reflecting on the legislation, regulation and control imposed in the US, the UK and Sweden concerning management's permitted as well as required actions in the face of a hostile bid, there is some similarity regarding the acquiring of independent advice and the ensuring that any decision is made within a specified period of time and after the disclosure of adequate amount of information. It is further clear that all three legal approaches are based on the fundamental presumption that the target's management decisions will always be effected by entrenchment motives. However, the three legislatures also inherit certain crucial differences, which are worthwhile emphasizing.

In the US, the acute decision to take use of defensive action rests upon the board, and the elbowroom for permitted action is in fact quite generous. Thus, as long as management acts in good faith and in a manner they believe is in the bests interest of their corporation, they are most surely protected from personal liability and judicial review. In the UK and Sweden, on the other hand, the margin of permitted action is vitally restricted due to the fact that defensive action rests solely upon the majority of shareholders and the role of the board is

strictly limited to that of an objective adviser. In this respect, it is obvious that the regulation of admissible defensive actions in UK and Swedish law respectively embrace a fundamental distinction that does not clearly appear in US law; the distinguishing between action adopted *a priori*, that is before a bid is imminent, and defensive action adopted *a posteriori*, that is after a bid has been launched.

In the UK, such a distinction means that any action taken *a priori* implies implication of ordinary statutory and common law where managerial behavior is regulated by the rules that concern the power of the shareholder majority, the fiduciary duties owed by directors to shareholders and the relevant limitations upon director's powers that are imposed the proper purpose corporate test. On the other hand, the very fact of the announcement of a bid triggers the implementation of the City Code on Takeovers and Mergers, compelling strict prerequisites on the magnitude of actions permitted to be taken by the board of directors. It is obvious that the prohibition against frustrating action significantly confines the margin of defensive actions that would be admissible for a target board, in order to defend against a hostile bid that already has been made, particularly as the prohibition extends even to actions not expressly stipulated by Rule 21. Consequently, the burden of decision concerning the defensive actions a target board may take in face of a bid lies solely in the hands of shareholders, which have the exclusive power to validate any defensive device. Notwithstanding, it is on the other hand also apparent that any action taken in conformity with a contract entered into before the emergence of a bid does not fall within the scope of prohibition imposed by Rule 21. Hence, with the exception of golden parachutes, which have to be entered into at least one year prior to a hostile bid, any agreements such as white knights, lock-ups and crown-jewels that have been signed for prior to a bid are binding for the target and the board bears the legal burden to execute its terms.

The general idea in Sweden is that management may enter into transactions, which with regard to the scope and nature of the company's operations are unusual or of great importance where the decision cannot be awaited without considerable inconvenience to the company. Thus, in view of Item II.13 of NBK's takeover recommendation, situations may occur in which counter-measures are justified without waiting for approval by the General Meeting, providing that it appears that the need for measure is both urgent and clearly in the interest of the company and its owners. This rule applies from the time the board or senior management of the target has good reason to assume that a serious offer is imminent, due to information received from a prospective bidder. Only if it is clearly essential that an action be taken with the greatest possible speed, in view of the need of the company and its owners, can the board act without approval from the General Meeting. My belief is thus that after a bid has been

launched, the target board can, just like in the UK, take any action that has been sanctioned by the shareholders in a general meeting and that does not conflict with the Companies Act. The main limitations are the principle of equal treatment of shareholders and the company's inherent goal of maximizing profit. However, as long as management does not have shareholder approval, the elbowroom for Swedish companies to take post bid defensive action is seriously circumscribed, clearly proving that the Swedish takeover regulation has inherited the fundamental principles of the UK City Code on Takeovers and Mergers. Moreover, from a comparative point of view, I find the Swedish conditions difficult to apply due to the very fact that the institutional ownership in Sweden is by all means relatively high, hence the use of defensive tactics in hostile situations has never ultimately been put at test, and most takeovers are communicated through negotiated deals between dominant owners. Consequently, as I mentioned earlier, the best post bid defense in Sweden is to appeal to the regulatory authorities.

Conclusively, the web of regulation can be deeply frustrating to directors of a company, which is subject to an offer, who may feel that the law and the regulators are conspiring against them. In reality, however, the regulations constrain offerors as much as target companies. Generally their objective is to secure that shareholders are not mislead and that none of the parties to offers unfairly discriminates between shareholders and that the ultimate decision whether or not the offer should be accepted rests with shareholders. Subject to this, even though the regulatory position needs close attention throughout an offer, it should not significantly impact on possible defenses. Defense planning must, therefore, ultimately be aimed at minimizing the risk that the views of shareholders and management are so far out of line that shareholders will accept an offer which management does not approve. The best way of doing this is lies not in discovering complex legal structures but in ensuring that the value of the company is reflected in its share price. As I mentioned earlier, the problem is not legal but commercial.

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Appendix 1
Thirteenth Directive Regulating Takeovers in the European Union

On September 14, 1990, the European Council formulated a proposal for a directive for the unified regulation of tender procedures of the member states of the European Union, the so-called Thirteenth Directive Regulating Takeovers in the European Union. The basic thrust of the regulation was to afford shareholders and other interested parties equivalent standards of protection. Although well developed, the Thirteenth Takeover Directive never became part of E.C. law. However, a thorough consultation with the member states was introduced in June 1993, which ended up in proposing a "framework" directive that does not endeavor a detailed harmonization but establishes general principles governing takeovers in the E.U., which each member state will be required to implement by framing its own explicit rules according to their national practices.[247]

Although the Council's aim to take actions dates initially from 1990, it was not until now, the end of year 2000, that political consensus permitted a takeover regulation to see the light of day in connection with the summit in Nice, France. The long road to consensus confirms the notable sensitivity of the subject, where the Member States have shown quite conflicting standpoints, against the background of their general opinions and questions on the power of undertakings and industrial policy in particular.

Thus, the aim of the directive is to provide an equivalent protection throughout the European Union for minority shareholders of companies listed on the stock exchange in the event of a change in control and to provide for minimum guidelines for the conduct of takeover bids, particularly as regards the transparency of the procedure. Moreover, the Directive provides the means of determining which is the competent authority for the regulation of a takeover, and which law is applicable, both of which are of crucial importance, especially in cross-boarder takeovers. The directive will further ensure a basic level of disclosure and information, thus guaranteeing transparency during the takeover bid.[248]

Most important in the context of my thesis is the fact that the Directive is to forbid the board of a target management from taking any defensive measures during the period of acceptance

[247] Radcliffe, N.C., (2000), *"The Thirteenth Directive on Company Law, concerning takeover bids"*, The Company Lawyer, Number 2, Volume 21, p.40
[248] The European Commission, Internal Market, Proposed Takeover Directive, December 12, 2000.

of a bid once it has received formal notice of the bid, unless it has prior authorization from a general meeting of shareholders convened for this specific purpose. As a compromise, however, the Directive is to give Member States the opportunity to increase the share capital during the acceptance period, if its general meeting of shareholders have approved such an increase not earlier than 18 months prior to the beginning of the offer period of acceptance of the bid and as long as the right of preemption of all shareholders is not excluded in whatever manner.

According to an article in the Economist of December 7 2000, the parliament's legal affairs committee approved several amendments to the Directive that *"made bankers and regulators hopping mad."*[249] The amendments would allow national supervisors to grant corporate boards the right to defensive measures to deter predators, without first obtaining shareholder approval. Such amendments would create a takeover regulation much like what is found in the US, i.e. in Delaware. As conciliation between the Council, the Parliament and the European Commission currently is on the agenda it is not clear what the outcome of the Directive will be. If the Regulation, including the above-mentioned amendments, is enacted, the takeover regulation in Sweden and the UK will be severely altered. As I have mentioned earlier, the Swedish manner of legislation and regulation is widely based upon the London City Code on Takeovers and Mergers, where post-bid defenses are very difficult to implement as long as shareholder approval is not granted. If however the Regulation is approved without amendments, the situation in the UK and Sweden will not change drastically. In these two countries, post-bid defenses need shareholder approval in almost all situations, which is precisely the basic thrust of the Directive, as long as the amendments are not included. Moreover as the Directive eliminates the possibility for Member States to keep weaker alternatives than a 1/3 mandatory bid rule, all Member States are obliged to guarantee the protection of minority shareholders by introducing a mandatory bid rule alike what is found in the UK. Thus, the mandatory bid rule is preserved, but not as the only means of minority shareholder protection, while the precntage of voting rights that confers control to a bidder and triggers the mandatory bid obligation is left to the discretion of the Member States, with no minimum limitations. From a Swedish perspective this is not a problem as the mandatory bid rule was already introduced in 1999.

[249] The Economist, December 7, 2000