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What are we protecting?

A study of the Swedish regulation of deal protection arrangements

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Summary

The thesis evaluates and examines the effects of the Swedish regulation of deal protection arrangements by looking to the impact of the provision on the Swedish capital market and target shareholders. The foundations of the Swedish takeover regulation are examined by presenting and arguing the relevant provisions in, and relationship between, stock exchange law, corporate law and EU law.

Fiduciary duties of target board directors in Sweden, the U.S. and the U.K. are examined. When takeover regulation apply, Swedish target boards are to exclusively observe the collective interest of the shareholders in any action in response to a takeover offer. The shareholders' interest in a takeover context is determined to be that of maximum return on their investment in relation to the offer and the opportunity to decide on the merits of a bid. Directors of U.S. companies are assigned fiduciary duties and must act in an informed and good faith manner in the interest of the company and its shareholders. These duties apply in a takeover situation and any action in response to an offer must be rational and constitute a reasonable response. Directors of U.K. companies must act in the interest of the company. The duties of U.K. directors in a takeover is to act in the interest of the company vis-à-vis the shareholders, maximize shareholder returns and not deny shareholders the opportunity to decide on the merits of a bid.

As for the relationship between fiduciary duties and deal protection arrangements, rule II.17a of the Takeover Rules prohibits Swedish offeree company boards from committing to any offer-related arrangements vis-à-vis an offeror. Although one may be granted an exemption from the provision, that possibility appears severely limited. In the U.S., deal protection arrangements are reviewed under the business judgement rule and ostensibly permissible. However, deal protections may be analogized to defensive measures and subject to an enhanced scrutiny only allowed within certain parameters. The U.K. regime is very similar to the Swedish and Rule 21.2(a)

of the Takeover Code prohibits offeree companies to enter into any offer-related arrangements. The rule is a product of a significant legal reform in 2011. This reform provided a unique opportunity to properly examine the effects of deal protection arrangements on target shareholders. Research shows a substantial and economically significant decline in deal volume in the U.K. after the prohibition was introduced. Moreover, there seems to have been no obvious equipoising benefits to target shareholders. The implications of the U.K. research are supported by research on break fees in the U.S. and Australia. The research on break fees suggests that such arrangements positively affect shareholder wealth by improving deal completion rate and facilitating larger premiums. However, it also shows that the beneficial properties of break fees are dependent on the size thereof.

Rule II.17a of the Swedish Takeover Rules is analyzed on the background of the economic research and regulation in the U.S. and U.K. The conclusion is drawn that deal protection arrangements appear to benefit target shareholders by promoting *ex ante* deal initiation and competing bids to a larger extent than it deters *ex post* competitive bidding. Prohibiting deal protection arrangements does not seem to yield higher premiums for target shareholders. Absolute prohibitions of deal protection arrangements appear to obstruct effective competition in the market and subsequent efficient allocation of resources, causing welfare losses. It is consequently doubtful if the Swedish prohibition strengthens target boards' negotiating position, is beneficial to shareholders or promotes a competitive takeover market. The adoption of a U.K. style of takeover regulation appears misguided as takeovers of Swedish listed companies appear more difficult than in the U.K. due to a larger presence of controlling shareholders. A U.K. style of regulation in Sweden may therefore have unforeseen detrimental effects when taking into account differences in ownership structures and market resiliency. Prohibiting deal protection arrangements may also promote a quantitative increase in irrevocables which may contribute to agency problems between minority and majority shareholders in Swedish companies. Such an increase may prove detrimental to the competitiveness of, and increase transaction costs on, the Swedish market. The possibility of being granted an exemption to rule II.17a

of the Takeover Rules does seemingly little to mitigate the potential detrimental effects.

All things considered, the analysis suggests that rule II.17a of the Takeover Rules does not improve competitive conditions, promote target shareholder value or strengthen target boards. The prohibition is therefore unwarranted as overall economic welfare would be improved under a less intrusive regulatory regime. It is suggested that a reversion to the previous regime where deal protection arrangements are allowed if they are in the interest of the shareholders may prove more beneficial for Swedish shareholders. In circumstances where market regulation is necessary, regulation that promotes the efficient allocation of resources should be favored, unless otherwise justified with regards to protective interests. As the prohibition does not seem to fulfill the outlined purposes, it should be evaluated on the basis of its actual effects. The provision therefore appears sub-optimal. Although a reversion would create new problems, these appear insignificant compared to the negative economic effects of the current regime.

Sammanfattning

Uppsatsen utvärderar och undersöker effekterna av den svenska regleringen gällande särskilda transaktionsavtal, s.k. budrelaterade arrangemang. Detta genom att undersöka regleringens effekt på den svenska kapitalmarknaden och målbolagsaktieägare. Grunderna för den svenska takeoverregleringen presenteras genom att undersöka de relevanta bestämmelserna i, och förhållandet mellan, aktiemarknadsrätt, aktiebolagsrätt och EU-rätt.

Sysslomannaansvaret för styrelseledamöter i svenska, amerikanska och brittiska målbolag undersöks. Då ett förvärv av bolaget är för handen och de svenska Takeover-reglerna är tillämpliga innefattar detta ansvar en plikt för målbolagsstyrelsen att tillvarata aktieägarnas intresse. Aktieägarintresset i ett svenskt målbolag synes enligt doktrin vara maximering av aktieägarvärdet och att alla aktieägare bereds en möjlighet att ta ställning till ett bud. Sysslomannaansvaret för amerikanska styrelseledamöter innefattar en plikt att agera informerat, i god tro och i bolagets och aktieägarnas intresse. Detta innebär att målbolagsstyrelsens agerande i en budsituation måste vara rationellt och utgöra ett skäligt gensvar. För brittiska styrelseledamöter innefattar sysslomannaansvaret i en budsituation en plikt att maximera aktieägarvärdet och bereda aktieägarna en möjlighet att ta ställning till ett bud. Vad gäller förhållandet mellan målbolagsstyrelsens sysslomannaansvar och budrelaterade arrangemang så kan det konstateras att II.17a i de svenska Takeover-reglerna förbjuder målbolagsstyrelser att gentemot budgivare binda sig till några budrelaterade arrangemang. Även om dispens för ett budrelaterat arrangemang kan medges av Aktiemarknadsnämnden så framstår denna möjlighet i praktiken som ytterst begränsad. I USA bedöms budrelaterade arrangemang närmast som en typ av försvarsåtgärd från målbolagsstyrelsen. Hindrande eller tvingande arrangemang är inte tillåtna såtillvida dessa förhindrar målbolagsstyrelsen att maximera budvärdet.

Den brittiska regleringen är betydligt mer lik den svenska. 21.2(a) Takeover Code är i materiellt hänseende likalydande med II.17a i Takeover-reglerna

och förbjuder målbolag att gentemot budgivare binda sig till några budrelaterade arrangemang. 21.2(a) Takeover Code är ett resultat av en omfattande reform av takeoverregleringen 2011. Denna reform medförde ett unikt tillfälle att studera effekterna av budrelaterade arrangemang. Den forskning som redogörs för i uppsatsen påvisar en omfattande minskning av transaktionsvolymen i Storbritannien efter att förbudet infördes, vilket tyder på att förbud mot budrelaterade arrangemang har en avskräckande effekt på bud. Vidare visar forskningen att målbolagsaktieägare inte har beretts något ytterligare värde i form av högre budpremier genom förbudet. De negativa konsekvenserna av ett förbud mot budrelaterade arrangemang styrks vidare genom forskning på särskilda budrelaterade arrangemang, break fees, i USA och Australien. Denna forskning visar att break fees bidrar till ökat aktieägarvärde genom ökade budpremier och större antal genomförda transaktioner. Forskningen tyder dock på de positiva effekterna är avhängiga storleken av dessa break fees.

Slutligen analyseras II.17a Takeover-reglerna i ljuset av takeoverregleringen i USA och Storbritannien och den ekonomiska forskningen på respektive transaktionsmarknad. Häri dras slutsatsen att budrelaterade arrangemang snarar tillför, än berövar, målbolagsaktieägare värde. Att förbjuda dessa arrangemang verkar således hindra effektiv konkurrens och därmed en effektiv resursfördelning. Det framstår således som tveksamt att det svenska förbudet uppfyller de syften som framhölls vid antagandet av detta, nämligen att stärka målbolagsstyrelsen förhandlingsposition, öka aktieägarvärde och främja konkurrensutsatta budsituationer i Sverige. Att utforma de svenska Takeover-reglerna efter de brittiska verkar i detta hänseende ha varit mindre välbetänkt då grundläggande olikheter i ägande- och marknadsstrukturer i respektive land kan medföra oförutsedda konsekvenser i Sverige. Förbudet kan vidare medföra att förekomsten av irrevocables (förhandsaccepter) ökar i Sverige. Detta kan förvärra agentproblematiken mellan minoritets- och majoritetsägare i svenska bolag såväl som medföra högre transaktionskostnader och hämma den effektiva konkurrensen. Dispensmöjligheterna i Takeover-reglerna gör till synes lite för att mildra dessa negativa effekter.

Sammanfattningsvis framstår det inte som att II.17a Takeover-reglerna uppfyller de mål och syften som låg bakom införandet av bestämmelsen. Det är svårt att se hur bestämmelsen ska kunna förbättra konkurrensmöjligheter, tillföra aktieägarvärde eller stärka målbolagsstyrelsens förhandlingsposition. Förbudet är således inte önskvärt ur ett ekonomiskt perspektiv då den sammanlagda välfärden skulle öka med mindre ingripande reglering. En återgång till det tidigare systemet där budrelaterade arrangemang tilläts såtillvida de ansågs vara i aktieägarnas intresse kan visa sig mer fördelaktigt för svenska aktieägare. När marknadsreglering är nödvändigt bör sådan reglering som främjar effektiv resursfördelning i största möjliga utsträckning förespråkas såtillvida inte andra legitima rättfärdigandegrunder föreligger. Då det nuvarande förbudet inte uppfyller de mål och syften som ansågs rättfärdiga detsamma bör det bedömas utifrån dess faktiska effekter. Sett till faktisk påverkan så framstår den nuvarande regleringen som opåkallat ingripande och suboptimal. Även om det en återgång till det tidigare systemet skulle medföra andra problem, så framstår dessa som obetydliga i förhållande till de potentiella negativa ekonomiska effekterna av den nuvarande regleringen.

Preface

Above all, I would like to thank my father for his unwavering and infinite support during these years. Who I am and what I have accomplished is by virtue of him.

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Abbreviations and Terminology

AMN	Rulings of the Swedish Securities Council
EU	European Union
Fiduciary	A person who acts on behalf of another person, or persons, to manage assets
M&A	Mergers and Acquisitions
NJA	Nytt juridiskt arkiv
Offeree Company	A company in respect of which an offer has been made or is in contemplation to
The Code Committee	The Code Committee of The Panel on Takeovers and Mergers
Target Company	A company that is the subject of an attempted acquisition by a potential buyer
Target Board	The board of directors of a target company
Target Shareholder	A shareholder in a target company
The Directive	Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids
The Takeover Code	The city code on takeovers and mergers
The Takeover Panel	The Panel on Takeovers and Mergers

The Takeover Rules	The Swedish Takeover Rules, Nasdaq Stockholm, 1 Apr 2018
U.K.	The United Kingdom of Great Britain and Northern Ireland
U.S.	The United States of America

1 Introduction

1.1 Background

A takeover is an acquisition whereby one company purchases shares in another company in order to take control of that company. The acquisition of a company is contingent on the approval of the shareholders of the offeree company. The shareholders of the offeree company are guided through the process by the board of directors who assist the shareholders in their decision-making and act as agents for the shareholders in the negotiations. There is some debate as to the scope of the board's authority in a takeover situation and some argue that the offer and negotiation thereof should be exclusively reserved for the shareholders. In accordance with this view, the role of the board is solely one of acting as an intermediary between the offeror and the shareholders of the offeree company. The board of the offeree company should consequently not have the authority to conclude any binding agreement with the offeror. Those who oppose this view maintain that although the shareholders ultimately decide on the merits of the offer, the board of the offeree company should take an active role and be able to negotiate with the offeror on behalf of the shareholders. Most jurisdictions incorporate both of these views. The board's freedom of action in takeover situations is consequently subject to legal constraints to facilitate an active takeover market while simultaneously protecting the shareholders right to decide on an offer. What the board is allowed, and not allowed, to do is of great importance to a potential offeror and the regulation thereof may promote or deter takeovers.

Acquisitions of publicly listed companies are costly affairs for offerors and offeree companies alike. Offerors have considerable costs to identify and subsequently assess suitable targets before launching a takeover bid while the shareholders of offeree companies risk value depreciation of their shares in the case of a failed acquisition. It is therefore in the interest of both parties to

contractually control and allocate the risk of the transaction. Such contracts are commonly referred to as deal protection arrangements. The most commonly used deal protection arrangements are indemnity arrangements that provide a party with compensation if a transaction is not concluded in pre-determined circumstances. The most prevalent indemnity arrangements are so called break fees that compensate the designated party with a predetermined amount, usually set to correspond with the party's estimated takeover costs or actual out-of-pocket expenses. Considering the potential effects of deal protection arrangements many countries have imposed restrictions on offeree company boards' freedom to enter into such arrangements.

Before February 2015 there were no specific rules regulating deal protection arrangements in Sweden. Instead, deal protection arrangements were subject to review under the general provision in rule II.17 of the Swedish Takeover Rules and admissible given that an arrangement was considered to serve the interest of the shareholders of the offeree company. In February 2015, rule II.17a of the Swedish Takeover Rules was introduced, prohibiting publicly listed offeree companies to commit to any offer-related arrangement vis-à-vis an offeror. The introduction of rule II.17a of the Swedish Takeover Rules has scaled back the role of the offeree company board by prohibiting the board from concluding offer-related arrangements with an offeror. Albeit deal protection arrangements insure the parties against unnecessary costs related to a takeover bid, they are sometimes held to provide a preferred offeror with an undue competitive advantage to potential competing offerors. Deal protections can be argued contrary to the interest of the shareholders of the offeree company as potential offerors may be disincentivized to launch a bid that is more beneficial for the shareholders. The benefits of deal protections are therefore disputed. Consequently, when regulating the use of deal protections, while attempting to ensure an active takeover market, the legislator must balance the interest of attracting initial offerors against limiting the deterring effects on competitive bidding. The relatively novel Swedish prohibition provides a good opportunity to analyze deal protection arrangements and examine how deal protection regulation should be designed

to ensure that the coveted equilibrium is achieved. The Swedish prohibition was introduced on a self-regulatory level and modelled on the deal protection rules of the U.K. Takeover Code. The absence of preparatory documents and sufficient case law requires an analysis of the prohibition from a comparative perspective taking into account both stock exchange law, corporate law, takeover regulation and ownership structure in different jurisdictions.

1.2 Purpose and research questions

The thesis aims to evaluate and examine the effects of the Swedish regulation regarding deal protection arrangements. In order to evaluate the Swedish regulation and achieve the purpose of the thesis, the U.S. and U.K. takeover regimes are analyzed from an economic and comparative perspective. Furthermore, the effects of deal protection arrangements, in particular break fees, in the U.S. and U.K. markets are examined to provide guidance as to the possible impact of deal protection arrangements on Swedish shareholders.

The principal questions addressed to achieve the purpose of the thesis are:

- How do deal protection arrangements relate to the interest of the shareholders in a publicly listed company?

- In what circumstances is prohibitive market regulation warranted?

- Does rule II.17a of the Swedish Takeover Rules promote target shareholder value, strengthen the negotiating position of target boards and contribute to a more competitive takeover market?

1.3 Delimitations

The thesis focuses on acquisitions of publicly listed limited companies, particularly companies listed on the Nasdaq OMX Stockholm. The term public acquisition or takeover is used in conformity with the definition in Chapter 2, Section 1, first paragraph of The Swedish Takeovers Act (SFS 2006:451). Private acquisitions or acquisitions of companies listed on Multilateral Trading Facilities (MTF) are consequently not discussed. The relevant rules regulating takeovers on the Nasdaq OMX Stockholm are identical to the ones applicable to companies listed on the Nordic Growth Market (NGM) and the discussion thereof is consequently relevant to companies listed on either exchange. Rationally, the focus of the thesis is on the larger exchange of the two, the Nasdaq OMX Stockholm.

Corporate law provides the basis for the analysis of stock exchange law and takeover regulation. As corporate law affects and modifies stock exchange law it is necessary to examine this regulatory relationship to answer the posed questions in the thesis. Issues of corporate law are consequently discussed and examined to the degree it is necessary for the relevant provisions in stock exchange law and takeover regulation. The interest of shareholders in the takeover process is discussed in the thesis. However, looking to the purpose of the thesis an all too lengthy and detailed discussion seems superfluous. Therefore, only selected aspects of the issue will be highlighted, leaving some of the background and reasoning thereof to the side.

The board of directors' capacity to adopt defensive measures and directors' liability is not discussed insofar as it is not intrinsically connected to the use of deal protection arrangements as the prohibition does not affect these matters to any significant extent. The directors of a target board, as elected representatives of the shareholders, ensure that shareholders are adequately represented and makes decisions as fiduciaries on their behalf. What is, and what is not, within the board of directors' authority in a takeover situation is contested. Consequently, one may argue that the Swedish regulation regarding deal protection arrangements is devised as a reflection of the

fundamental fiduciary structure and asserts the view that target boards may not conclude any binding agreements with offerors. However, as the thesis focuses on the actual effects on target shareholders, and efficiency of the Swedish regulation, the prohibition will not be evaluated on the basis of the abovementioned systematic.

There is no closer examination of EU law as the applicable EU regulations are modelled on the U.K. takeover regime and have been implemented in Sweden by national law.

1.4 Method and research material

The thesis mainly employs a legal dogmatic method to examine the meaning of the relevant legal rules. The sources of law are methodically processed to determine the applicable law. As the thesis incorporates both corporate law and stock exchange law, a large variety of the sources of law are used. With regards to corporate law, the sources of law have been analyzed in the order stipulated by the doctrine of the sources of law (*Sw. rättskälleläran*). The law, legislative history, precedents and legal doctrine have consequently been analyzed in this order.[1]

As the thesis focuses on acquisitions of companies listed on the Nasdaq OMX Stockholm, the Swedish Takeover Rules in addition to other provisions in stock exchange law will be paramount for the discussion. Stock exchange law is regulated on a self-regulatory level as well as by legislation and the sources of law, their significance and position in the hierarchy of the doctrine of the sources of law are therefore different.[2] However, the rules that apply in a public acquisition can also be hierarchically ordered. The companies listed on the exchange are contractually obligated vis-à-vis the exchange to abide by the rules of the exchange and these rules are consequently of great importance to the conduct of listed companies. The Takeover Rules have the character of

[1] Korling & Zamboni (2013) p. 21 ff.

[2] Stattin (2009) p. 30.

semi-official regulation and should, as a primary source, be interpreted objectively and in accordance with the purposes thereof.[3] The commentary to the Takeover Rules are an integral part of the regulation and are part of the interpretation insofar as such an interpretative inclusion is coherent with the purposes of the Takeover Rules.[4] The Takeover Rules are consequently interpreted in accordance with the purposes and fundamental principles thereof. The hierarchically subordinate commentary to the Takeover Rules is used to determine these purposes and principles. Corporate law provides the fundamentals of stock exchange law and principles of corporate law therefore permeate the stock exchange law. It is therefore both possible and necessary to consider principles in corporate law when stock exchange law provides no answer, and vice versa.[5]

In some cases, there are uncertainties as to the meaning of certain legal rules discussed in the thesis which requires that these are determined. Insofar as there are uncertainties or conflicting opinions advocating two different interpretations on the meaning of a rule and the legal dogmatic method provides no answer; an economic analysis of the law as outlined in chapter 2 of the thesis is used to argue the applicable law. The subsidiary use of the economic analysis of the law to argue the applicable law where the legal dogmatic method does not suffice is motivated by the economic dimension of the relevant legal rules, questioning and the issues discussed in the thesis. The economic analysis of the law can in these circumstances be used to establish a solution that promotes overall welfare.[6] It must be considered necessary to take into account socioeconomic aspects when analyzing market regulation as the effects thereof stretches beyond the confines of the market and its primary actors.

[3] Eklund & Stattin (2016) p. 392.

[4] AMN 2004:21.

[5] Stattin (2009) p. 39.

[6] Dahlman et al. (2010) p. 216.

Deal protection arrangements are a relatively novel and previously uncommon phenomenon in Sweden and there is limited guidance to be found regarding such arrangements in Swedish legal doctrine and empirical research. To properly evaluate the impact of deal protection arrangements it is therefore necessary to examine the U.S. and U.K. legal systems where deal protection arrangements have been prevalent and plentiful research exists. The comparison to the U.K. is further motivated by the fact that the Swedish takeover regulation is modelled on the U.K. takeover regime and guidance can be sought in the U.K. rules in situations where the Swedish rules provide no clear-cut answer. There is limited guidance pertaining to certain issues and it must be considered motivated that I to some extent draw my own conclusions from the available research and legal doctrine.

In chapter 12, economic research regarding specific deal protection arrangements, break fees, is presented. The presented research is chosen on the basis of its impact, measured by the extent to which it has been cited in other studies. Furthermore, to ensure that the material is up-to-date and relevant, only contemporary empirical research that focuses on deal completion rates, premiums, shareholder benefits and competitive bidding has been selected. The applicability of the research is somewhat limited in regard to the Swedish provisions as it focuses on foreign markets. However, as no comprehensive research on deal protection arrangements on the Swedish market currently exists, the selection must be considered befitting as it provides important guidance to the possible impact of the Swedish provision, taking into account legislative differences and divergencies in ownership structure.[7]

The thesis frequently refers to Stattin's ”Takeover – offentliga uppköpserbjudanden på aktiemarknaden enligt svensk rätt”. Considering the changeful nature of stock exchange law, the book may be regarded as somewhat dated. However, the relevant rules and principles discussed are predominantly the same. In the non-applicable instances, the latter ”Aktiebolagsrätt och aktiemarknadsrätt” by Eklund and Stattin provides

[7] Stattin (2009) p. 237.

guidance. Stattin's 2009 book is used as it is one of the most notable contributions to the subject in Swedish legal doctrine.

1.5 Disposition

The analysis in the thesis is continuous. However, the bulk of the analysis is concentrated to the general discussion in chapter 13. The fundamental aspects of the economic analysis of the law is presented in chapter 2 as it is necessary to grasp these concepts for the following discussion. Similarly, in chapter 3, the fundamentals of the stock market are presented showing how the stock market functions and the need for stock markets and regulation thereof. Chapter 4 examines the relationship between stock exchange law and corporate law in Sweden and establishes how potentially conflicting provisions should be interpreted.

In chapter 5, the relevant EU legislation is presented. Chapter 6 introduces the Swedish Takeover Rules and how these relate to EU and U.K. legislation and regulatory compliance. In chapter 7, the relevant provisions of Swedish company law are presented and the role of the target board and the directors' duties in a takeover context are discussed. Chapter 8 provides for the fundamental aspects of deal protection arrangements and irrevocable commitments. In chapter 9, the Swedish deal protection regulation is presented and rule II.17a of the Takeover Rules is examined.

Chapter 10 provides for a comparative perspective on directors' duties and deal protection regulation in the U.S. Chapter 11 adds to the comparative perspective in chapter 10 by examining directors' duties and takeover regulation in the U.K. As the Swedish Takeover Rules are modelled on the U.K. regulation there is a comprehensive analysis of the U.K. Takeover Code and the 2011 reform of these rules. In chapter 12, economic research on deal protection arrangements, with a focus on break fees, is presented. This section extensively examines the impact of deal protection arrangements on target company shareholder benefits by looking to deal completion rates, premiums

and competitive bidding. Finally, in chapter 13, the economic research, motives behind rule II.17a of the Swedish Takeover Rules and the impact the prohibition may have in the Swedish market are analyzed, the provision evaluated and potential solutions to the presented issues are discussed.

2 Economic Analysis of the Law

2.1 General analyis

The economic analysis of the law explores how the economy relates to legal rules and is used to study the social desirability of these rules and how they affect the behavior of individuals and groups. It aims to explain and predict the behavior of firms and individuals as well as improve legislation by studying the economic consequences thereof. It is assumed that individuals make decisions that maximizes personal satisfaction. Furthermore, the assumption that firms and individuals are forward looking and rational is a cornerstone of neoclassical economics applied in the economic analysis of the law.[8] Overall social welfare is increased by the production, and subsequent transfer, of goods and services and transactions entails gratification as buyers acquire coveted products and sellers receives money in return. Voluntary transactions are therefore presumed beneficial despite the absence of new value being added to the economy as overall welfare has increased by the sum of the individuals' respective prosperity.[9] The law is a tool that can be used to promote economic efficiency[10] and improve market conditions. The

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[8] Posner (1998).

[9] Dahlman et al. (2010) p. 10.

[10] Economic efficiency can be characterized in many ways, including allocative, productive, informational or dynamic. In the following discussion, the concept of economic efficiency is used as a tool of welfare analysis to measure the impact of markets and regulation on society and mainly defined in terms of allocative efficiency Allocative efficiency is achieved when capital is allocated in a way most beneficial to the parties involved and where the welfare of an individual cannot be improved by reallocating resources or goods without subsequently making others worse-off.

economic analysis of the law is multifaceted and often divided into separate disciplines. It is imperative for the following discussion to grasp the fundamental economic aspects of the law, and the ostensibly most important theories are therefore presented.

2.2 The Chicago School

The Chicago school of economics is a neoclassical school of economic thought based on the concept of rational expectations. Milton Friedman's quantity theory of money holds that economic growth is easier to control in a world where decisions on economic allocation are made in a rational way. According to the rational choice theory, societal behavior reflects the sum of decisions made by individuals and that these individuals choose the action or outcome they most prefer. Rationality is thus used to assume the behavior of individuals in economic models and study economic efficiency.[11] Furthermore, the Chicago School is essentially libertarian and laissez-faire and proposes that the reduction or elimination of regulation on businesses is beneficial to the economy. It is argued that regulation leads to inefficiency as interest groups and other political actors will shape the regulation to benefit themselves. Governmental interference in the market mechanism is therefore only desirable when the markets fail.[12]

2.3 Agency theory

Conflicts of interest are inherent in situations where an agent is expected to act in the best interest of a principal. Agency problems occur when a principal does not possess full knowledge about the future actions of the agent and the agent's interests and incentives do not align with those of the principal. Agency problems are common in fiduciary relationships and the agency problem in a corporate context usually refers to the conflict of interest

[11] Korling & Zamboni (2013) p. 184.

[12] See for example George Stiegler's *Economic Theory of Regulation.*

between shareholders and managers. The managers, as agents of the shareholders, are supposed to make decisions that maximize shareholder wealth. However, the managers interests do not align with the shareholders' as the managers will look to maximize their own wealth and shareholders cannot fully know to what extent the managers are working in their interest. The principal aims to pay minimum for maximum profit while the agent strives for maximum compensation for as little work as possible.[13] Agency problems can lead to market failure as companies may be run inefficiently. Costs associated with inefficiencies that may be the result of agency problems and costs of managing the principle-agent relationship are referred to as agency costs. Such costs are predominantly attributable to monitoring costs, bonding costs and residual losses.[14] To minimize agency costs, the relationship is often regulated by contracts as well as legislation. Generally, the responsibility lies with the principal to incentivize the agent to act in their best interest and various contractual arrangements such as performance-based compensation structures are used. Furthermore, the threat of dismissal or takeovers (the market for corporate control) and managerial ownership creates incentives for managers to act in the interest of the shareholders. Regulation regarding fiduciary duties further mitigate agency problems and costs.[15]

2.4 Transaction cost theory

Transactions are, with some apparent exceptions, beneficial to the prosperity of society. It is therefore a collective interest that transactions are concluded to the greatest extent possible. Costs of concluding a transaction with another party can be divided into costs of contact, contract and control. The costs of

[13] Eklund & Stattin (2016) p. 161.

[14] Monitoring costs are costs borne by the shareholders to monitor and restrict the activities of management. Bonding costs are the corresponding costs borne by management to assure that they are working in the interest of the shareholders. Residual losses are the costs incurred from diverging principal and agent interests that may still remain despite the use of monitoring and bonding.

[15] Panda (2017) p. 83 ff.

contact are costs to find a supplier, the costs of contract are costs associated with the purchase such as negotiation costs and the costs of control are costs of risk-minimizing such as monitoring the other party and the quality of the goods.[16] Organizational structure can affect the control of a transaction and consequently the costs thereof. Given an efficient organization the organizational costs are likely to be lower than the costs of concluding the external transaction. It is therefore in the interest of companies to internalize transactions to the largest extent possible to reduce costs associated with the uncertainties and risks of an external transaction.[17] Transaction costs are affected by bounded rationality and the opportunism of individuals in the market. Thus, in contrast to the Chicago School of thought, one cannot presume rational decisions from individuals in transaction cost economics. Individuals are limited in their decision-making by the availability of information, cognitive capacity and time available to decide. These bounds on rationality inevitably causes individuals to make satisfactory decisions instead of rational ones, regardless of intention.[18] Long-term prosperity is consequently sacrificed for short-term gains.[19]

High transaction costs impede the function of the market as actors lack incentives to invest or dispose of their assets. Thus, when transaction costs rise to the level where transactions are no longer economically motivated, there may be market failure. The market is most efficient in the absence of transaction costs and no governmental interference is therefore necessary. However, the non-existence of transaction costs is merely wishful thinking as such costs exist in all markets, even if the levels may vary. If transaction costs are high enough as to impede the function of the market, regulation is necessary to ensure an efficient allocation of resources. When analyzing the law from an economic perspective one must consequently establish the threshold where regulation is warranted.[20]

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[16] Dahlman et al. (2010) p. 85.

[17] Coase (1937) & Williamson (1994).

[18] Herbert (1957).

[19] Korling & Zamboni (2013) p. 187 ff.

[20] Dahlman et al. (2010) p. 83.

3 The Stock Market

3.1 The role of the stock market

The term ''stock market'' refers to the markets and exchanges where the issuing and trading of equities and stocks of publicly listed companies take place. Stock markets are the cornerstones of the free market economic system as they efficiently allocate capital to businesses that provide in-demand products and services to the public. The stock market reward companies that grow market share in the market or industry they operate within and punish those who do not as the access to capital is performance-dependent. In a fully efficient stock market low performing companies are either acquired by stronger competitors or liquidated and taken out of the market. In addition to providing companies with access to capital by offering shares and corporate bonds, the stock market promotes individual investor participation in the financial accomplishments of companies via dividends and capital gains by providing a trading platform and facilitating the flow of information. The open exchange facilitates pricing from available information and provides transparency for individual investors to make informed decisions and control their risk accordingly.[21] Trading on the stock market is done by supply and demand pricing and share prices will be a function of the available information in a functioning market.[22] There are two main sections in the stock market, the primary market and the secondary market. In the primary market, shares are sold by initial public offerings or otherwise when a company issue new shares. The secondary market includes all other trade on the open exchange and does not directly provide companies with capital but gives individual investors the opportunity to dispose of their shares.[23]

[21] SOU 2004:69 p. 58.

[22] Prop. 1990/91:142 p. 74.

[23] Sevenius (2017) p. 33.

3.2 Transaction costs on the stock market

Short-term investments are necessary for a company's long-term positive development. However, in the absence of an open exchange, the realization of short-term investments may suffer as potential buyers of shares wants to be guaranteed the possibility of future disposal of their shares. Together with the risk that transaction costs may surge in the absence of a stock market[24] it diminishes the incentives for short-term investments as costs are too high in relation to potential earnings. The existence of an open exchange significantly reduces transaction costs as it facilitates the flow of information between sellers and buyers who may otherwise have no means of communication. While contracting costs may remain high due to the nature of a transaction and the costs of overseeing the market are dependent on the structure thereof, it is easier for actors in an open exchange to survey supply and demand and place orders to buy and sell.[25]

3.3 Regulatory needs

Economic welfare requires efficient allocation of resources, i.e. to use the resources where positive output is maximized. Efficient allocation requires effective competition in the market and markets are often at their most efficient when they remain unregulated.[26] Regulatory intervention should therefore, from an economic perspective, only be motivated when the market is failing, or transaction costs are too high. Despite the notion that the most efficient market is an unregulated one, stock markets around the world remain heavily regulated. Government intervention is usually motivated by the market's failure to efficiently use allocated resources. Such failure may be

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[24] See Chapter 2.3.

[25] Pehrson (2007) p. 376 ff.

[26] See Chapter 2.1; SOU 2006:50 p. 140.

due to external effects causing negative externalities.[27] Consumers make their decisions based on marginal cost and benefit and do not consider the cost of negative externality. Producers on the other hand, when dealing in goods that have negative externality, have lower marginal costs than they would otherwise have. In an unregulated market this will lead to inefficient allocation of resources and external costs being passed on to society.[28] Another motive for regulating markets are information failures where one party to a transaction possesses greater information and knowledge than the other. A typical example of information asymmetry in the stock market is the informational discrepancy between company insiders and the general public.[29] In addition to negative externalities and information failure, public interests of protecting the integrity of the financial systems and consumer protection also motivates market regulation.[30]

Furthermore, trust is an important factor of participation in the stock market as investors are exposed to numerous risks when trading on an open exchange and studies have shown that individuals with higher trust in the stock market are more likely to hold stock.[31] Investment decision are made on the basis on available information and corporate fraud revelations has been shown to decrease the probability of participation due to lower trust in the stock market.[32] In addition to being cheated by companies there is a risk in financial and governmental institutions and institutional instability and corruption can negatively affect investors' trust in the stock market as well as other external factors. Waning trust in the stock market will consequently impair the stock market's functions as investors shy away from further investments, creating an unfavorable snowball effect.[33] In addition, there are external factors that

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[27] Negative externalities are costs suffered by a third party as a result of an economic transaction between a producer and a consumer where neither have to pay the full cost of a decision.

[28] SOU 2006:50 p. 141.

[29] Ibid p. 142.

[30] Ibid.

[31] Guiso et al. (2008) p. 2557 ff.

[32] Giannetti & Wang (2014).

[33] Prop. 2006/07:115 p. 266.

negatively affects capital markets which needs to be controlled. Thus, market regulation such as disclosure requirements are used to maintain public trust in the stock market. Investors can rely on share prices accurately reflecting the market and transaction costs remain low as there is no need for additional information gathering before an investment.[34] Minimal interference in the market will in theory yield the most efficient allocation of resources. Yet, in practice there is a need to maintain public trust in the capital markets by means of regulation.

3.4 Stock Exchange Law & Corporate Law

Stock exchange law as a separate legal discipline can broadly be defined as the rules and regulations governing publicly listed companies. Issues regarding corporate governance, corporate control and disclosure requirements of publicly listed companies are governed by the stock exchange law.[35] It is in its essence based on corporate law and the fundamental principles thereof pervades stock exchange law. Likewise, provisions and principles of corporate law are modified by stock exchange law and the two legal disciplines are intertwined. One cannot study the one without acknowledging the other.[36] Publicly listed companies are governed by these different sets of regulation with diverging purposes and objectives. The scope of corporate law is beyond publicly listed companies, as it regulates the foundation, operations and administration of corporations in general.[37] In contrast, stock exchange law exclusively regulates the activities and transfer of shares of publicly listed companies. Inevitably there are situations where

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[34] Sevenius (2017) p. 30.

[35] Stattin (2009) p. 35 ff.

[36] Ibid p. 39.

[37] Lindskog (2017) p. 54.

different objectives of the regulations conflict and what is in accordance with one set of rules may not be permissible under the other.[38] Thus, the subsequent discussion will require an understanding of the relationship between the two and is of particular importance to the issues concerning fiduciary duties and shareholder interest.

Publicly listed companies must adhere to regulations in corporate law and other applicable peremptory rules. Due to inconsistencies, some provisions in corporate law have to give way for established practices on the stock markets and obligations derived from stock exchange law that may conflict with corporate law are given right of priority.[39] Public listings as means of raising capital are acknowledged by corporate law and the rules that a public company must follow cannot be hindered by generally applicable provisions in corporate law. If so, companies would be caught between conflicting provisions and their actions considered unlawful regardless of which set of rules they choose to follow. Of course, this does not mean that other actions acknowledged by stock exchange law are prohibited by provisions in corporate law per se.[40]

Although the symbiosis is ambiguous, the notion that publicly listed companies cannot circumvent peremptory provisions in corporate law with reference to established principles or practices on the stock market is certain.[41] Public companies' freedom of action is therefore restricted by creditor-protection rules and other compulsory provisions. Potentially conflicting principles should be interpreted together to the extent possible. If not possible, an ad hoc interpretation should determine whether the provision in corporate law has been modified by stock exchange law or if the provision remains unaffected and interpreted accordingly.

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[38] Ibid p. 55.

[39] Lindskog (2017) p. 55.

[40] Nyström et al. (2018) p. 196.

[41] Ibid p. 71.

4 The Takeover Directive

To facilitate the free movement of goods and services within the European Single Market the European Parliament adopted Directive 2004/25/EC of the European Parliament and of the Council of 21 april 2004 on takeover bids (the Directive). As the most important EU legislation regarding takeovers, the Directive aims to restore investor confidence in the integrity of the EU capital markets and tackle agency problems by creating a healthy and competitive cross-border market for corporate control that facilitates takeovers, creates incentives that restricts self-dealing and maximizes shareholder value and economic welfare.[42] The Swedish takeover legislation is based on the Directive and the applicable rules shall be applied and interpreted in conformity with the requirements of EU law.[43] The Directive requires implementation by national legislation but allows for Member States to implement certain provisions by self-regulation, albeit such authority must be designated by national law according to Article 4 of the Directive. In accordance with abovementioned Article 4, Chapter 13, Section 8 of The Swedish Securities Market Act (SFS 2007:528) stipulates that an organized exchange shall have rules relating to takeover bids that fall within the Directive's scope of application. The rules on the exchange shall meet the requirements and follow the guiding principles of the Directive. Chapter 2, Section 1, first paragraph of The Swedish Takeovers Act (SFS 2006:451) stipulates that a takeover offer on an organized exchange can only be made if the offeror has committed to follow the rules and regulations on the exchange where the target company's shares are listed. The target company on its part is contractually obligated vis-a-vis the exchange to follow the rules and regulations of the exchange.[44] In practice, the application and interpretation of the principles in the Directive will therefore be conducted on a self-regulatory level and often undertaken by private authoritative bodies.

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[42] McCahery & Vermeulen (2010) p. 3.

[43] C-14/83, Von Colson & Kamann v Land Nordrhein-Westfalen.

[44] Nyström et al. (2018) p. 15.

5 The Swedish Takeover Rules

The two regulated markets in Sweden, the Nasdaq OMX Stockholm and the Nordic Growth Market (NGM) have adopted identical takeover rules that govern takeover bids on companies whose shares are listed on the respective exchange (the Takeover Rules). The Takeover Rules apply throughout the various stages of the takeover process and provide a general framework which is to be observed by offerors and offeree companies alike. The provisions are based on principles derived from the Directive and the Directive provides guidance to the interpretation of the Takeover Rules and their objectives.[45] The Takeover Rules have similar provisions to those of the U.K. Takeover Code and a comparable formal structure and both the Takeover Rules and the Directive are modelled after the Takeover Code.[46] The application and interpretation of the Takeover Code in the U.K. consequently offers significant guidance for the interpretation, application and analysis of the Swedish Takeover Rules.

The main supervisory body of takeovers on the Swedish regulated markets is the Swedish Securities Council. As with the Takeover Rules, the Securities Council is modelled on its U.K. counterpart and is in many aspects intended to fulfill the same role as the Panel on Takeovers and Mergers in London.[47] Together with the Swedish Corporate Governance Board and the Swedish Financial Reporting Board the Securities Council forms the Association for Generally Accepted Principles in the Securities Market which through statements, advice and information promotes generally accepted practices on the Swedish stock market.[48] According to rule I.2 of the Takeover Rules, the Securities Council has the authority to issue certain rulings concerning the

[45] Introduction to the Nasdaq Stockholm Takeover Rules, 1 Apr 2018.

[46] Prop. 2005/06:140 p. 34.

[47] SOU 2003:22 p. 64.

[48] Section 14 of the Statutes of the Association for Generally Accepted Principles in the Securities Market.

interpretation and application of the rules as well as grant exemptions.[49] One of the key components in the Securities Councils application and interpretation of the Takeover Rules are the generally accepted practices on the stock market and publicly listed companies are obliged to comply with the practices thereof.[50] The generally accepted practices on the stock market can be used by the Securities Council in unregulated areas when it is deemed necessary to achieve the purposes of the relevant rules, or normatively in response to new events on the stock market.[51] The takeover legislation is intrinsically linked to other legal disciplines and in the context of promoting generally accepted practices the Securities Council will inevitably be forced to make considerations regarding corporate law.[52] For the following discussion it is therefore necessary to explore the principles and provisions of Swedish corporate law that complements the legal framework in takeover contexts.

[49] The authority is granted through delegation by The Swedish Financial Supervisory Authority in Chapter 7, section 10 of the Act on Public Takeover Offers on the Stock Market (FFFS 2006:4).

[50] Section 5 of the Nasdaq OMX Stockholm Rule Book for Issuers.

[51] Stattin (2009) p. 137.

[52] Section 15, first paragraph of the Statutes of the Association for Generally Accepted Principles in the Securities Market.

6 Swedish Company Law

6.1 The role of the target board

An offer is addressed to the shareholders of the target company and it is the shareholders who ultimately decide if they should accept or decline an offer. Consequently, the target company and board are not party to the transaction per se and not legally affected by the offer in itself unless the directors themselves hold shares. However, this does not mean that the board of directors of the offeree company (target board) is excluded from the takeover process altogether. Despite the nature of an offer and the restrictions imposed on directors' authority in takeover regulation, the target board holds an indirect power to defend against or promote an offer by their support and recommendation. The often relatively dispersed ownership structure of a publicly listed company provides that many private individual shareholders do not have access to the necessary information or possess the knowledge or skill to properly evaluate an offer.[53] Empirical studies have shown that the recommendation made by the target board is an important variable in determining takeover outcomes.[54] Thus, the target board's recommendation will inevitably affect target shareholders' decision to accept or decline an offer. An offeror, if not hostile, will therefore often approach the target board before launching a bid to discuss the terms of a potential offer in an attempt to secure the support of the target board.[55] As advisors, the target board should provide the shareholders with an informed assessment of the merits of a bid. Yet, concerns about whether target boards sufficiently consider the appropriate interests and implications of a takeover, and how they communicate these, are often raised.

[53] Davies & Hopt (2009) p. 235.

[54] Clarke (2010).

[55] For example, Kraft's approach in the takeover of Cadbury 2010. For more details see chapter 11.4.

According to rule II.19 of the Swedish Takeover Rules the target board has an obligation to announce its opinion regarding an offer and the reasons thereof within two weeks of the expiry of the acceptance period. In the recommendation statement, the board can choose to recommend or to not recommend the shareholders to accept an offer. Furthermore, the board, as a representative of the target company's shareholders can conclude various offer-related arrangements with the offeror to facilitate the success of an offer. Any costs incurred to fulfill these obligations are to be reasonable and induced by the interest of the shareholders.[56] The target board shall evaluate the offer in the interest of the shareholders and in response take a course of action that it deems appropriate. Evaluating a takeover offer is a delicate task that requires more effort and commitment than the everyday management of the company. The evaluation is often time-sensitive and the bidder, shareholders, media, supervisory authorities and other stakeholders may exert pressure on the board to ensure they act in their respective interest.[57] Wrongful or improper conduct from the target board may not only induce additional costs or harm the company and its stakeholders but could also expose the board to liability. Evaluating an offer and subsequently taking action in response to that offer is consequently hazardous for the target board. As the target board's evaluation and recommendation of the offer is of utmost importance to the success of the transaction, the inherent agency problem between shareholders and directors raise concerns. How can shareholders trust that the board is acting in their interest in a takeover process and that arrangements with an offeror and a recommendation of an offer is the most beneficial for them? Provisions and principles in company law, alongside the Takeover Rules, aim to mitigate the issues that may arise in a takeover situation and align the interests of directors and shareholders.

[56] Nyström et al. (2018) p. 220.

[57] Stattin (2009) p. 331.

6.2 Fiduciary duties

There are few statutory restrictions regarding the overall conduct of the board in Swedish companies. Chapter 8, Section 41 of the Swedish Companies Act (SFS 2005:551) contains a general clause that prevents directors of the company from any legal actions resulting in an undue advantage to a shareholder or another person to the detriment of the company or a shareholder. Any undue advantage may be considered to have been given if the act is not in the interest of the company and cannot be justified from a business standpoint.[58] According to Chapter 8, Section 4 of the Swedish Companies Act, the board of directors is responsible for the organization of the company and the management of the company's affairs. Chapter 8 Section 35 of the Swedish Companies Act further stipulates that the board of directors represents the company and signs its name. Thus, irrespective of what duties that can be interpreted into the general clause, the directors, as representatives of the company, are charged with a fiduciary duty to protect the interests of the company and its shareholders.[59]

To fulfill their fiduciary obligations the directors must observe the duties of care and loyalty when making corporate decisions. Although the duties are interlaced, and the application frequently overlapping, the respective duty can be applied under different circumstances and should from a comparative perspective preferably be held separate. The principal purpose of the duty of loyalty is to restrict self-dealing whereas the duty of care aims to ensure that the board observes due care and acts in the interest of the company.[60] Just like in the everyday management of the company, the directors must act in the interest of the company when facing a takeover.[61] The duty to act in the interest of the company when facing a takeover is further acknowledged in rule II.17 of the Takeover Rules. Rule II.17 stipulates that the board of the offeree company is to act in the interest of the shareholders in matters relating

[58] Samuelsson, commentary to Section 41, Chapter 8 of the Swedish Companies Act.

[59] Lindskog (2017) p. 65.

[60] Stattin (2008) p. 362 ff.

[61] Sandström (2017) p. 213; Stattin (2009) p. 65.

to the offer. The provision complements the general fiduciary duties of the target board and specifies which interests are to be protected in the takeover process. The rule may seem superfluous as the directors are charged with their fiduciary duties in any decision relating to corporate matters. However, considering the continuous discussion and discord in Swedish corporate law regarding the company's interest, the provisions appear necessitous.

6.3 Company and shareholder interest

According to the abovementioned fiduciary duties, the directors must act in the interest of the company and its shareholders. The traditional and most widely supported opinion amongst Swedish legal scholars is that the interest of a limited company is ultimately the interest of the shareholders.[62] However, there is no general agreed upon definition and the interest of the company in a given situation is dependent upon which rules that apply under the circumstances.[63] This actualizes the question of which interests the target board is to observe when takeover regulation apply. The Takeover Rules are subject to the guiding principles of the Directive and should be interpreted and applied in a manner that is consistent with the purpose of the Directive. Thus, pursuant to Article 3.1(c) of the Directive, the target board must act in the interest of the company as a whole and not deny shareholders the opportunity to decide on the merits of a bid. In the direct application and interpretation of the Directive or the Swedish Takeovers Act, Stattin argues that the company's interest is first and foremost the interest of the shareholders but that, in the light of Article 3.1(c) of the Directive, stakeholder interests are to be recognized unless a certain provision indicates a singular safeguarded interest. Stattin notes that the same consideration could be made when interpreting the Takeover Rules but as rule II.17 states that the board is to act in the interest of the shareholders, any stakeholder interests are

[62] See Skog (2018) p. 246; Dotevall (2017) p. 142; Nerep & Samuelsson (2009) commentary to Section 47, Chapter 7 of the Swedish Companies Act.

[63] Stattin (2009) p. 67 ff.

precluded.[64] The nominated singular interest of the provision should take precedence over the general interpretative principles and possibility to observe stakeholder interests.[65] Rule II.17 hence prohibits the target board from observing any other stakeholder interests in the takeover process, something that may otherwise have been at their discretion. The target board is to exclusively observe the collective interest of the shareholders in any action relating to the takeover offer.[66] What is to be considered the interest of the shareholders is subject to intensive debate.

The interest of the company is considered to be the collective economic interest of the shareholders according to Stattin.[67] The collective interest of the shareholders is dependent upon the circumstances in a given situation. In essence, the collective interest of the shareholders can be determined by a hypothetical interest looking to the smallest common interest among the shareholders.[68] From an economic analysis of the law the smallest common interest among shareholders should be the return on the capital they invested in the company. The return on investment could come in the form of capital appreciation or dividends as means of direct value extraction. Capital appreciation could be measured by looking to the company's cash flow, balance sheet, income statement, share price or a combination thereof. However, using the share price as the sole standard of capital appreciation does not seem appropriate. It is hard to determine what actually caused a fluctuation in the share price and isolate a single event contributable to an act or omission by the board. Furthermore, how should one use the share price as a benchmark for appreciation? Should the share price continuously climb or is it satisfactory that the share performs better than listed competitors in the same sector? The share price alone can, in my opinion, only provide a suitable standard for capital appreciation if it is a direct function of the company's

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[64] Stattin (2009) p. 80.

[65] This view has been upheld by the Securities Council. See for example AMN 2007:10 & AMN 2008:43.

[66] Nyström et al. (2018) p. 217.

[67] NJA 2013 p. 117.

[68] See for example Östberg (2016a) p. 464; Stattin (2008) p. 214.

performance. Looking to the nature of the market it is quite uncertain if this is always the case as different events may have varying effects on the share price regardless of the actual economic implications for the company. A change of direction in a company that is communicated to the market may result in a brief depression of the share price, even though the change might provide for long-term shareholder value. The share price as a single standard also provides incentives for short-termism from directors and is consequently less appropriate. Capital appreciation as the interest of the shareholder collective should therefore be measured by an overall long-term positive development of the company as reflected by the company's financial status as well as the share price, disregarding transient fluctuations thereof.

Applying the abovementioned standard in a takeover context, the shareholders' interest is that of maximum return on their investment in relation to the offer. Considering the purpose of the Takeover Rules and stock exchange law's influence on corporate law, the opportunity to decide on the merits of the bid should also be in the interest of the shareholders.[69] Any action or omission by the board in relation to the offer must therefore be evaluated on whether it was intended to maximize the return on shareholder investments. A recommendation of the bid under rule II.19 of the Takeover Rules by the board should accordingly only be made if the control premium offered accurately reflects the takeout value under current management and structure. As far as deal protection arrangements are concerned, they should theoretically only be allowed if the shareholders are ensured a greater return on their investment under such arrangements than in the absence thereof.

[69] Nyström et al. (2018) p. 219.

7 Deal Protection and Irrevocables

7.1 Definition and function

Deal protection arrangements are a type of offer-related arrangements related to an M&A transaction that involves a publicly listed company and provides value to a bidder if a transaction is not concluded in pre-determined circumstances.[70] The purpose of deal protections is to deter competing bids and protect a preferred offeror. Takeover bids are costly for offerors as they will incur direct expenses in relation to identifying analyzing, appraising, and performing due diligence of a target company as well as opportunity costs. It is also time-consuming and diverts management's attention from everyday operations.[71] Likewise, the transaction is a matter of prestige as being outbid in a public acquisition may be detrimental to the reputation of the offeror and its directors. Failed acquisitions drive management turnover and exposes the company to strategic vulnerabilities.[72] The target board cannot bind the target company to a change of control transaction and there will always be a degree of uncertainty as to the merits of the bid and the likelihood of the offer being accepted by the shareholders, especially in a widely held company with a dispersed ownership structure. An offeror consequently desires some form of protection against being drawn into a potential bidding war and risking unnecessary expenses. Some offerors are therefore reluctant to initiate a takeover process without the safeguarding that deal protection offers.

Typical examples of deal protections are arrangements that restricts the offeree company's search for, or negotiations with, other potential offerors. Other common deal protections are fees payable to the bidder under certain circumstances if the transaction is not concluded. Deal protection arrangements can have an insurance-like function by covering the costs of a takeover bid as well as provide the offeror with a competitive advantage

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[70] Coates & Subramanian (2000) p. 310.

[71] Hatch (2000) p. 1268.

[72] Davis (2008) p. 17.

against competing bidders.[73] Due to potential deterring effects it is argued that deal protections are contrary to the interest of target shareholders as they could impede the materialization of, or possibility to seek out and negotiate, a more beneficial offer.[74] Nevertheless, there are situations in which target boards believe that the company could benefit from deal protection. Firstly, target companies incur costs for analyzing and evaluating the bid during the recommendation process. Secondly, an unsuccessful transaction could result in a loss for the shareholders by negatively affecting the share price. If an offeror decides to withdraw a bid after having been given access to thoroughly examine the target company it may send a negative signal to the market. Other investors will presume that the withdrawal was due to rational financial concerns and, at least temporarily, abstain from further investments which will depress share prices.[75] Target boards may therefore justify a deal protection arrangement to avoid costs associated with an unsuccessful transaction. Lastly, the target board may have confidence in a specific offeror's long-term abilities to run the company and believe that the takeover would benefit shareholders and stakeholders alike. Or they may deem it a necessity to the success of the transaction to accept deal protection.[76] Depending on the circumstances it may therefore also be argued that deal protections are beneficial to target shareholders.

There are nonetheless reasons to doubt the target board's judgement and motives for accepting deal protection when considering agency problems. Directors may very well be led by ulterior motives and self-dealing and decisions tainted by short-termism are particularly likely to occur when facing a potential takeover. An offer that is not necessarily the most beneficial for the shareholders may provide better opportunities for continued employment and increased compensation than potential competing bids. This could be the case when the offeror via the takeover is entering a new market and needs the

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[73] Stattin 2009 p. 238.

[74] Davis (2008) p. 18.

[75] Stattin (2009) p. 238 ff.

[76] For instance, when the target board considers it unlikely that a competing bid would emerge and an offeror makes a potential bid dependent on such arrangements.

expertise and experience of the incumbent management.[77] The target board could also be motivated by the deal itself as it would build on their managerial reputation and use their position to attract an offeror and ensure a successful transaction. Considering the deterring effect and agency problems relating to deal protections, many countries have introduced legal constraints to mitigate the risk of shareholder interests being neglected. As a majority of takeovers are beneficial for the target company's shareholders, regulators try to strike a balance between keeping the insurance-like function to attract initial offerors while limiting the deterring effect of the arrangements.

7.2 Different types of deal protection

The most common types of deal protections can be divided into two different categories. Arrangements that control the offeree company's dealings with other potential offerors and indemnity arrangements. Indemnity arrangements are commonly referred to as termination-, inducement- or break fees depending on the structural arrangement. Hereafter, the term break fee will be used when discussing these arrangements. A break fee is usually triggered if a deal proposal is terminated for certain specified reasons, including external, or if a contract is terminated before expiration. It provides an incentive for the target company to complete the transaction as they may otherwise be contractually obligated to compensate the offeror. The break fee in itself varies but it is usually set to correspond with the offerors estimated transaction costs. However, it could be also set as a percentage of the value of a successful competing bid (topping fee) or it could be set to cover the offerors actual out-of-pocket expenses (expense-reimbursement provision).[78] Subject to a break fee, a competing bid must be higher than the combined value of the initial bid and the break fee to provide additional value for the target company's shareholders. A competing bidder will consequently have greater costs for launching a bid if the target company has entered into a deal

[77] Davis (2008) p. 18.

[78] Stattin (2009) p. 262 ff.

protection agreement with another bidder. To function as an efficient contracting device, break fees should only be accepted by the target board when the arrangement is necessary to entice a bid from an offeror that would not have launched a bid in its absence, be it an initial bid or a competing one.[79] If one would view break fees as efficient contracting devices they should promote the emergence of competing bids. However, it would likely result in fewer successful bids and lower deal completion volume compared to when applying agency theory. Due to the principal-agent problem, directors will protect their own interests instead of the shareholders' and break fees may be used to promote and lock in deals with a preferred offeror whose interest align with the directors', discouraging potential competing bids.[80]

Arrangements that control the offeree company's dealings with other potential offerors are certain types of exclusivity arrangements that lock the target company to an initial offer by disincentivizing negotiations with competing bidders. Frequently used arrangements include no-shop and no-talk provisions.[81] A no-shop clause prevents the target company from actively seeking out potential competing bids or in other ways promoting the emergence of a competing bid.[82] But, a no-shop clause will not prevent the target company from negotiating with a competing offeror if that offeror was the one who initiated the negotiations. The more intrusive no-talk clauses prevent the target company from negotiating or communicating with any competing offerors at all.[83] Exclusivity arrangements often incorporate so called fiduciary-out clauses. Fiduciary-out clauses are designed to prevent a situation where the directors fiduciary duties conflict with those of an arrangement with an offeror. The clauses often provide that no commitments made in the agreement will relieve directors of their duties towards shareholders.[84]

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[79] Chapple et al. (2006) p. 644.

[80] Ibid.

[81] Ibid p. 257 ff.

[82] Sautter (2008) p. 534.

[83] Ibid p. 534 ff.

[84] Stattin (2009) p. 268.

7.3 Irrevocables

Although not a deal protection arrangement per se, irrevocable undertakings are used by offerors to achieve the insurance-like function of deal protections. Instead of, or in combination to, approaching the target board to conclude an arrangement with the target company an offeror may approach target shareholders directly. An irrevocable is an agreement where a target shareholder commits vis-à-vis an offeror to accept a future takeover offer. An irrevocable may be hard (binding in all circumstances), semi-hard (generally ceases to be binding if a higher offer is made, exceeding the initial offer by a set amount) or soft (ceases to be binding if a higher offer is made).[85] An offeror can reduce the risk of an unsuccessful takeover by securing support for an offer from target shareholders by using irrevocables, often with block-holders. Irrevocables encourage *ex ante* deal initiation as deal completion is more likely with contractual shareholder backing and the offerors apprehension to incur takeover costs therefore reduced. Bearing in mind the prohibition of deal protections and offerors' interest of risk mitigation, irrevocables will undoubtedly be sought more often and earlier on in the takeover process. The increasing importance of irrevocables thus warrants a brief review of the applicable rules.

The Swedish takeover regime mainly regulates irrevocables in regard to disclosure requirements.[86] According to rule II.3 of the Takeover Rules, an offeror must announce a takeover bid as soon as possible in a press release. Rule II.3 point 4 of the Takeover Rules stipulates that the offeror must include the extent to which he has received binding or conditional commitments to accept the offer from target shareholders in the public announcement. Irrevocables are allowed and commonly used in the Swedish takeover market and may even incorporate warranties from target shareholders [87] Besides

[85] Ibid p. 196.

[86] The question of whether irrevocables can be seen as price-sensitive information is not discussed as it is outside the scope of the thesis. The problems concerning director shareholders and irrevocables are not discussed either.

[87] AMN 2016:16.

potential disclosure obligations the Takeover Rules do not define irrevocables or introduce any restrictions on the parties' dealings as regards irrevocables. Although common practice, irrevocables are a relatively novel phenomenon in the Swedish market and additional guidance regarding these instruments can be sought in U.K. regulation. The U.K. Takeover Code defines an irrevocable as an irrevocable commitment to accept or not accept an offer, or to vote in favor of or against a resolution of an offeror or the offeree company in the context of an offer.[88] Rule 4.3 of the Takeover Code requires the offeror to consult with the Takeover Panel before contacting individual shareholders to ensure that the arrangement will provide adequate information as to the nature of the commitment and give shareholders an opportunity to decide on the merits of such an arrangement.[89] The most noticeable difference between the two regimes is the U.K. requirement to consult the Takeover Panel before concluding an arrangement with a target shareholder. One could argue that similar requirements would benefit actors in the Swedish market as prior consultation would guarantee the legitimacy of the irrevocable and ensure that shareholders are properly informed and aware of the consequences of the undertaking. However, seeing as irrevocables are market standard in Sweden and the freedom of contract extensive[90], a consultation requirement would impose an unnecessary and substantial encumbrance on the designated authority. Furthermore, it would increase the offeror's transaction costs. Consequently, I cannot see the benefits of introducing a similar requirement in the Swedish takeover regulation.

[88] U.K. Takeover Code section C14.

[89] U.K. Takeover Code section E3.

[90] Irrevocables with far-reaching undertakings such as warranties has been upheld by the Securities Council, see AMN 2016:16.

8 Deal Protection Regulation in Sweden

8.1 Rule II.17a of the Swedish Takeover Rules

The Swedish deal protection regulation is modelled after the U.K. regulation and very similar to rule 21.2 of the U.K. Takeover Code. Rule II.17a of the Takeover Rules stipulates that an offeree company may not commit itself to any offer-related arrangements vis-à-vis the offeror. The term offer-related arrangement refers to all arrangements related to the offer that entails an obligation on the offeree company vis-à-vis the offeror, excluding certain clauses and obligations.[91] The purpose of the regulation is to level the playing field between offeror and offeree by counteracting any arrangements that may deter potential offerors from launching a competing bid on the company, i.e. deal protection arrangements.[92] Although the regulation is directed towards the target company, the effect in practice is informing offerors of the target company's limited possibility to agree to any deal protection arrangements. The prohibition in rule II.17a is not absolute, and the Swedish Securities Council can grant an exemption in situations where they believe that an offer-related arrangement would promote rather than deter competing bids according to rule I.2 of the Takeover Rules. Exemptions are granted on a case-to-case basis and the Securities Council shall make an overall assessment of the situation and take all relevant circumstances into account.[93]

Although deal protections have historically been a somewhat rare occurrence in the Swedish takeover market, the increasing presence of foreign offerors led to an upswing in the time leading up to the prohibition.[94] In response, it was held necessary to protect the target board from being pressured into entering an arrangement by offerors asserting that Swedish target boards were obliged to do so in the interest of the target company or that not doing so

[91] For example: Confidentiality clauses and obligations to solicit certain stakeholders.

[92] Commentary to Rule II.17a Nasdaq Stockholm Takeover Rules, 1 Apr 2018.

[93] Sjöman & Skog (2015) p. 43.

[94] Stattin, Deal protection och god sed på aktiemarknaden, p. 50.

would expose the target board to liability. The Swedish Corporate Governance Board held that a prohibition would contribute to a more competitive takeover market and strengthen the negotiating position of the target board. Furthermore, the Corporate Governance Board explicitly declared that it was necessary for Sweden to follow in the regulatory footsteps of the U.K.[95] Rule II.17a of the Takeover Rules was subsequently introduced on the 1st of February 2015. Before 2015 there was no regulation on deal protections, instead any such arrangement was governed by rule II.17 of the Takeover Rules and allowed as long as the terms were lawful and the arrangement in the interest of the shareholders. The provision was revised in 2012 to provide that deal protection arrangements were allowed if the target board deemed it necessary due to ''special reasons''. However, no prohibition was considered necessary and the term ''special reasons'' was not defined, leaving considerable leeway for the target board to commit to deal protection arrangements.[96] In summary, the target board could commit to deal protection arrangements pre 2015 as long as the terms of the arrangements were lawful, in the interest of the shareholders and there were special reasons to do so.

Rule II.17a of the Takeover Rules indicates that deal protection arrangements in general conflict with the board's fiduciary duties.[97] The restrictions were introduced to repel arrangements that may deter potential competing offers and have a lock-in effect, resulting in lower premiums and limiting the shareholders decision to a single offer. Deal protection arrangements are therefore presumed to not be in the interest of the shareholders. Before rule II.17a of the Takeover Rules was introduced any decision of the target board relating to deal protection arrangements would have been subject to the restrictions imposed by the duty of care to act in the interest of the company. In a takeover context, the duty towards the company is to act in the interest of the shareholders according to rule II.17 of the Takeover Rules. As stated earlier, Chapter 8, Section 41 of the Swedish Companies Act prohibits directors from any legal actions resulting in an undue advantage to a

[95] Swedish Corporate Governance Board, Press release 2014-12-12.

[96] Sjöman & Skog (2015) p. 42.

[97] Nyström et al. (2018) p. 227.

shareholder or another person to the detriment of the company or a shareholder. The term ’’another person’’ has a wide scope of application and an initial or competing offeror can be the recipient of an undue advantage as a legal person. Deal protection arrangements that deter competing bids or depress the final premium offered could therefore constitute an undue advantage if it is deemed not in the interest of the shareholders and cannot be justified from a business standpoint. However, if a deal protection arrangement lowers the threshold for an initial offeror to launch an offer it can be argued that it is in the interest of the shareholders.

Arrangements that were not in the interest of the shareholders would presumably have been prohibited by the target boards’ fiduciary duties and rule II.17 before the prohibition was introduced. Rule II.17a could therefore be argued superfluous. Nevertheless, there are situations where the benefits of deal protection arrangements are contentious.[98] It should also be noted that the question of whether an action was in the interest of the shareholders or not was subject to the scrutiny of the courts under the former system. Although shareholder litigation will linger under Rule II.17a of the Takeover Rules, it eliminates any uncertainty as to the lawfulness of the action and the difficulties and costs for shareholders to prove a violation of the directors’ duties.

8.2 Exemptions to rule II.17a

There are situations where the interests of the shareholders may conflict. Hypothetically, a potential offeror that is willing to pay a larger premium than target shareholders could otherwise plausibly expect to receive in a competitive market may only be willing to launch a bid if the offeror is granted some form of security or exclusivity.[99] A deal protection arrangement would in these cases promote maximum return on the shareholders’ investment but deter a possible competing bid and the shareholders’

[98] See Chapter 8.1.

[99] For example via a non-shop or non-talk clause.

possibility to decide on the merits of that bid. Seeing as there is no guidance as to which of these interests should prevail, it should be determined on a case-to-case basis. The argument could be made that the Securities Council should grant an exemption from rule II.17a of the Takeover Rules in these circumstances. The subsequent commentary to rule II.17a of the Takeover Rules stipulates, after exemplifying specific situations, that

’’..reasons for exemption may also conceivably exist in other cases where a particular arrangement improves rather than reduces the prospects of a competitive bidding situation. When considering an exemption, the full circumstances of the situation are to be considered, whereupon certain arrangements may be deemed acceptable while others are not accepted.’’[100]

Looking to the statements in connection to the introduction of rule II.17a one can presume that deal protections are presumed restrictive and detrimental to the prospect of any competing bids emerging. The possibility of being granted exemption therefore seems limited. An exemption may be granted if there are good prospects of a competing bid being launched regardless of the target company’s dealings and the arrangement is paramount to the initial offeror. Furthermore, it is possible that the target company may be granted an exemption to attract an initial offeror if the prospects of a competitive situation is entirely ruled out given the circumstances. Then again, such situations appear unusual as the incentives for a potential offeror to demand deal protection should be limited if the situation is of such a special nature that competing bids are out of the question. However, in a situation where the possibility of competing bids exists, but an initial offer is so high that it is unlikely that such a premium could be obtained in a bidding war, there seems to be no possibility of exemptions as it would not improve the prospects of a competitive bidding situation. Due to the inflexibility of the regulation and the limited possibilities to be granted an exemption, the target board may become more risk averse and shareholders risk missing out on beneficial offers.

[100] Commentary to the Nasdaq Stockholm Takeover Rules, 1 Apr 2018, p. 44.

9 Fiduciary Duties and Deal Protection in the U.S.

9.1 U.S. regulation

Takeovers in the U.S. are subject to federal regulation through the Securities Act of 1933, the Securities Exchange Act of 1934, the Williams Act Amendment of 1968. Takeovers are also regulated at state level and state corporate laws regulate directors' duties in takeover situations.[101] Almost 50 percent of publicly listed companies in the U.S. are incorporated in Delaware and Delaware corporate law has had substantial influence on public companies in the U.S. The Delaware courts' extensive experience in corporate adjudication has led to other states seeking guidance from Delaware case law and replicating Delaware corporate law provisions.[102] Although there has been a progressive decrease in Delaware incorporations, Delaware state law still appears the most appropriate to convey a general depiction of U.S. state takeover regulation.

9.2 Fiduciary duties

Delaware law allows the target board considerable freedom of action in a takeover and the board determines whether an offer shall be referred to the shareholders to decide on the merits of the bid. The U.S. model has been argued to allow target boards to protect shareholders against opportunistic offerors as target boards can strengthen their negotiating position via deal protections and defensive measures.[103] While a hostile bidder can bypass the target board by launching a tender offer and initiating a proxy contest to remove the incumbent management it is undoubtedly more advantageous

[101] Seretakis (2013) p. 274.

[102] Mann & Roberts (1998) p. 664.

[103] Davies & Hopt (2009) p. 157.

having the support of the target board. In the face of a hostile tender offer U.S. target boards may, within certain limits of their fiduciary duties, trigger poison pills or shareholder rights plans to dilute the offerors stake in the company and staggered boards may further complicate matters for a hostile offeror.[104]

Directors of U.S. companies are assigned fiduciary duties requiring them to act in an informed and good faith manner which they believe is in the best interest of the company and its shareholders as well as avoid any conflicts of interest.[105] To facilitate managerial power and corporate decision-making the Delaware courts introduced the business judgement rule that provides a presumption that directors have acted in accordance with their fiduciary duties.[106] The general fiduciary duties apply in a takeover context but are supplemented by an enhanced form of scrutiny. Any actions in response to a takeover must be rational and the target board has an obligation to determine whether the offer is in the best interest of the company and its shareholders under the Unocal/Unitrin doctrine. If the target board believes that an offer is not in the best interest of the company and its shareholders they may adopt defensive measures. For such measures to be allowed under Unocal/Unitrin the target board must show that they had reasonable grounds to believe there was a threat to the corporation and that their actions were proportionate to the threat. If the they can show this, their actions come under the protection of the business judgement rule and the burden shifts back to the plaintiff to show a breach of fiduciary duties.[107] It is enough that a threat is substantively coercive to satisfy the threat-requirement under Unocal/Unitrin.[108] Furthermore, actions that are within the range of reasonable responses and neither coercive nor preclusive are considered proportional. As long as the

[104] Bebchuk et al. (2002) p. 887 ff.

[105] Wang (2013) p. 101.

[106] Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

[107] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

[108] See the court's reasoning in Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989). A risk that shareholders accept an underpriced offer due to confusion or mistrust in the board's assessment of an offer is enough to constitute a substantively coercive threat.

target board does not try to force a preferred offer on shareholders, deprive shareholders of the right to decide on the merits of the bid or fundamentally restrict an offeror from seeking control their actions will be upheld by the courts.[109] U.S. target boards therefore have substantial freedom to adopt defensive measures allowed under the company's constitution if it represents a reasonable response to an offer so inadequate that it threatens the company. Nevertheless, there are situations where the target board has an obligation to facilitate a deal and are not allowed to entrench itself. When there are offers that make a dissolution or breakup of the company appear inevitable the role of the board changes.[110] The board must abandon their position as defenders of the company's long-term objectives and try to obtain the highest value available for the shareholders in a sale process.[111] Defensive actions in circumstances where the Revlon doctrine apply are therefore likely to be considered a breach of the directors' fiduciary duties.

9.3 Deal protection arrangements in the U.S.

Consistent with the more lenient approach to takeover defenses, Delaware law allows the use of break fees and other deal protection arrangements although subject to certain limitations. Deal protection arrangements are reviewed under the business judgement rule. Directors are presumed to have acted on an informed basis, in good faith and in the belief that their actions were in the best interest of the company and its shareholders. The burden of proof is on the plaintiff to reverse the presumption by showing a breach of fiduciary duties. However, deal protection arrangements should be subject to an enhanced review under the Unocal/Unitrin standard as the deterring effects of deal protections can be analogized to takeover defenses. U.S. target boards therefore have some leeway in adopting deal protections.[112] If deal protections are used when a breakup of the target company appears inevitable

[109] Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (Del. 1995).

[110] Primarily when there are two or more viable offers for control.

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

[112] McMillan v. Intercargo Corp., 768 A.2d 492 (Del. 2000).

or there is a change of control, the Revlon doctrine will apply. Under Revlon, the target board must try to get the highest value reasonably attainable for the target shareholders.[113] The Revlon rule overlaps with the Unocal/Unitrin doctrine and the business judgement rule and the Unocal/Unitrin scrutiny should apply simultaneously to achieve an efficient regulation that safeguards shareholder protection. Preclusive or coercive deal protections should therefore not be upheld, even if they are considered reasonable under Revlon.[114] Deal protection arrangements are consequently not allowed if they unreasonably interfere with the boards obligation to maximize deal value. As deal protection arrangements may deter competing bids, the target board must show that the arrangement has given shareholders substantial benefits by *de facto* fostering competitive bidding or securing the highest available offer.[115] As regards *ex ante* deal initiation or in situations where there are no competing bids this may prove difficult for the target board. To show that a deal protection arrangement is beneficial to the shareholders in these situations the target board must show that the preferred offeror's bid is the best that could reasonably be obtained under the given circumstances. A thorough market test should be conducted to ensure that there are no other offerors or that potential competing offers are significantly lower than the preferred offer.[116]

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[113] Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989).

[114] Restrepo & Subramanian (2017) p. 36.

[115] Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989).

[116] See Lyondell Chemical Co. v. Ryan, 970 A.2d 235 (Del. 2009). A go-shop clause could be used to permit the target company to find competing bids for a limited period of time post-signing but prior to completion.

10 Takeover Regulation in the U.K.

10.1 The U.K. Takeover Code and Takeover Panel

The U.K. takeover regime has for a long time advocated open markets, company neutrality and shareholder empowerment. The advantages of a U.K. style of regulation can be illustrated by the American takeover experience of the 1980s. Junk bond financing and takeover schemes such as two-tier front-end loaded tender offers[117] enabled corporate raiders to effortlessly acquire target companies by coercing target shareholders into quickly tendering their shares.[118] Although U.S. federal regulation provided some protection by requiring tender offers to be held open for twenty days, U.S. companies were essentially at the mercy of hostile offerors until shareholder rights plans, poison pills, were introduced.[119] Under the applicable U.K. takeover regulation at the time, two-tier tender offers were prohibited and mandatory bidding requirements would have made it harder to gain control of a target company. The fundamental values and advantages of a U.K. style of regulation has inspired a large number of countries to adopt similar provisions. The Swedish takeover regulation is based on the Directive, which in turn draws heavily on the U.K. Takeover Code.[120] As the Swedish rules are to be interpreted in accordance with the Directive one may look for guidance in the provisions of the Takeover Code and the Takeover Panel's rulings and statements when interpreting the Swedish Takeover Rules.[121] The U.K. Takeover Panel was founded 1968 as the supervisory authority of the U.K. Takeover Code. According to Chapter 1of Part 28 of the Companies Act 2006 the Takeover Panel is responsible for creating provisions and issuing rulings relating to takeovers, mergers and other change of control transactions. The

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[117] A so called "Saturday night special".

[118] Patrone (2010) p. 355.

[119] Securities and Exchange Act of 1934, 15 U.S.C. § 78 (2010) (as amended by the Williams Act of 1968).

[120] See Chapter 6.

[121] Stattin (2009) p. 256.

Takeover Panel, via the provisions in the Takeover Code, aims to promote the integrity of the financial markets and maintain a regulatory regime regarding takeovers. The Takeover Panel is however not concerned with any financial or commercial disadvantage of a transaction but leaves such concerns to the concerned parties, the target company and its shareholders.[122] The Takeover Panel has a strong voice with the U.K. government, companies and the public and their opinion on takeover-related matters is respected. Beyond issuing rulings, the Takeover Panel can provide guidance to the interpretation of the Takeover Code by issuing Practice Statements. Although not legally binding, these statements provide important guidance to how a provision is likely to be interpreted by the Takeover Panel in future rulings.[123]

The Code aims to facilitate accurate and adequate disclosure of information and protect target shareholders in a takeover. Moreover, the Code puts restrictions on target boards to ensure that they do not interfere with the shareholders right to decide on the merits of a bid or otherwise take a course of action that may frustrate the shareholders' choice. The U.K. regulation prevents directors from taking frustrating action without prior approval of the shareholders at a general meeting. U.K. companies, just like Swedish, are therefore unable to adopt defensive measures or other tactics that would prevent shareholders from considering an offer.[124] The role of U.K. target company boards is hence limited to expressing an opinion on the merits of the bid and provide shareholders with relevant information. Section A of the Takeover Code stipulates that the Takeover Code is based on the fundamental principles in Article 3 of the Directive. Section B of the Takeover Code provides for six general principles, of which the most important for the following discussion is General Principle 3. General Principle 3 states:

"The board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid."

[122] Section A1.2(a) of the Takeover Code.

[123] Section A6(a) of the Takeover Code.

[124] Rule 21.1 of the Takeover Code.

General Principle 3 corresponds to the principal purpose of the Takeover Code stipulated in Section A1.2(a). The provision stipulates that the code is designed to ensure that target shareholders are treated fair and equal and not denied an opportunity to decide on the merits of a bid. Any actions undertaken by the target board is thus subject to scrutiny under General Principle 3 and must be in the interest of the company as a whole. The Takeover Panel can grant an exemption from certain provisions if it is deemed to be in accordance with General Principle 3. It should also be noted that the Takeover Code is designed neither to facilitate nor impede takeovers, although the provisions certainly have an effect on deal activity on the market.

10.2 Deal protection arrangements in the U.K.

Rule 21.2(a) of the Takeover Code stipulates that the offeree company may not enter into any offer-related arrangements with the offeror. An offer-related arrangement is defined by rule 21.2(b) as any arrangement in connection with an offer, excluding certain arrangements such as confidentiality agreements and letters of intent. Before 2011, break fees and other deal protection arrangements were allowed. But, the use of break fees was subject to certain restrictions. The break fee had to be construed *de minimis* and capped at one percent of deal value, meaning that the break fee had to be as low as possible and generally not exceeding of the cap. In addition, the target board and the target company's financial advisors had to give notice to the Takeover Panel that they considered the arrangement to be in the interest of the shareholders.[125] There are theoretically both positive and negative effects of deal protection, and the Takeover Panel can consent to the use of break fees if it is in the interest of the target shareholders under Note 1 and 2 on Rule 21.2. However, in the following year after the prohibition was introduced, dispensation under Note 1 on Rule 21.2 was not sought at all

[125] The Takeover Panel Code Committee, Review of certain aspects of the regulation of takeover bids, 2010, Consultation Paper Issued by the Code Committee of the Panel PCP 2010/2, p. 82.

while dispensation under Note 2 was sought only once although there were 16 instances where an exemption may have been granted.[126] The use of deal protection arrangements in the U.K. market has consequently decreased dramatically. The extensive limitations in the provision has had the effect of a prohibition rather than a prohibitive presumption.

10.3 Fiduciary duties in U.K. company law

Parallel to takeover regulation, U.K. company law will limit the target board's freedom of action. Directors of a publicly listed company in the U.K. are at all times subject to a statutory duty in Section 172(1) of the U.K. Companies Act 2006. Section 172(1) stipulates that a director must ''act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole''. Before the codification, directors were subject to a common law fiduciary duty to act in the interest of the company and Section 172 now incorporates the separate duty to act in the interest of the company and older case law remains relevant to the interpretation of the provision. Section 172 differs from common law insofar as the target board are required to promote the success of the company for the benefit of current and future[127] shareholders instead of the company as a separate legal entity.[128] Although stakeholder interests are to be considered, the provision provides that the interest of the shareholders should remain the chief focus in the board's corporate decision-making.[129] The success of the company is reflected by the collective goals of the shareholders, disregarding any special interests of a particular shareholder or selection of shareholders. In the absence of limitations in the articles of association, the shareholders interest in a publicly listed company is presumed to be a long-term increase

[126] The Takeover Panel Code Committee, Review of the 2011 amendments to the Takeover Code, 2012/8, p. 14.

[127] It should be noted that the fiduciary duties in Swedish corporate law does not stipulate any obligation to observe interests of future shareholders.

[128] Kershaw (2012) p. 382 ff.

[129] Ministerial statements Companies Act 2006, Duties of company directors (DTI, 2007) p. 7.

in value and the accompanying return on shareholder investment.[130] The company's interest is hence one of maximizing the returns for shareholders.

The directors' duties to act in the interest of the company are reaffirmed in General Principle 3 of the Takeover Code when the company is subject to a takeover offer. The provision stipulates that the board of a target company must act in the interest of the company as a whole and not deny shareholders the opportunity to decide on the merits of a bid. These obligations are derived from Article 3(1)(c) of the Directive and the boards of all publicly listed EU companies have a similar obligation when faced with a takeover.[131] The target board must advise shareholders on the offer and avoid taking any action that might frustrate the bid or deny shareholders of the opportunity to decide on the merits of the bid.[132] The relationship between directors and shareholders in a takeover situation differs from that which exists in the day-to-day management of the company. In a takeover situation, the target board are merely acting as agents of the target shareholders in advising and guiding the shareholders through the process. When directors have assumed, or been obliged by law, to act as middlemen between the shareholders and the bidder they owe their fiduciary duties directly to the shareholders.[133] Thus, during a takeover process the target board must act in the interest of the company vis-à-vis the shareholders. To ensure that the target board acts in the interest of the company, the term must be defined. It may be argued that the interest of the company as a whole include stakeholder interests in the light of Article 3.1(c) of the Directive. General Principle 3, rule 25.1 of the Takeover Code and Section 172 of the Companies Act could, when read together, be interpreted to provide an obligation for the target board to always observe stakeholder interests in takeover-related decisions. On the other hand, the meaning of the provisions could also be interpreted to provide that stakeholder interests should merely be considered for the benefit of the

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[130] Kershaw (2012) p. 306.

[131] See for example rule II.17 of the Swedish Takeover Rules

[132] General Principle 2, Rule 3.1, Rule 21, 23 and Rule 25.1 of the Takeover Code.

[133] Mukwiri (2009) p. 86.

shareholders.[134] Furthermore, the relationship between directors' general duties in Section 172 of the Companies Act and the specific duties in General Principle 3 of the Code is ambiguous. It is argued that the Takeover Code takes precedence as special law and that it should not be interpreted in accordance with company law as it would be contrary to the aims of the Takeover Code and interfere with its autonomy.[135] A parallel application of the general fiduciary duties would support a shareholder primacy model, restricting what flexibility may arguably exist within the framework of the takeover regulation.[136] To resolve the conflict of overlapping duties Mukwiri argues that directors' general duties should be treated as being sui generis to a class of stakeholders affected by the actions of directors of the company involved in a takeover bid.[137] Looking to the purposes of the Directive and the wording of Section 172, this seems like the most reasonable solution in my opinion. Although stakeholder interests may be considered, they should be secondary to the interest of the shareholders and merely provide guidance as to what is most beneficial for the shareholders.

Yet, the interest of the company may vary as different shareholders may have different preferences. The divergence of interest between shareholders is often due to different investment preferences where one shareholder may prefer short-term gains over long-term prosperity. The issue with misaligned shareholder preferences was evidenced in the Cadbury takeover. When subject to a bid that may not be in the long-term interest of the company as a continued independent entity but offers a fair price to the shareholders the target board will be conflicted. Are the target board under such circumstances obliged to evaluate the bid on the basis of how the takeover will serve the company's long-term increase in value or simply look to the premium offered?[138] Rationally, the target board will be forced to an *ad hoc* solution.

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[134] Kershaw (2012) p. 46–47.

[135] See the decision in Eurotunnel P.L.C., 2007/2, Takeover Appeal Board.

[136] As the company's interest is nominated by Section 172 of the Companies Act 2006 as an interest of maximizing the returns for shareholders.

[137] Mukwiri (2009).

[138] Corporate Briefing by Herbert Smith Freehills (n 103) p. 2.

Seeing as the target board owe their fiduciary duties to the members of the company as a whole, they should act to maximize overall shareholder interests.[139] This will inevitably lead to balancing and choosing between different shareholder preferences where interests worth protecting may be sacrificed for differing majority interests. Although the Cadbury takeover may not have ended differently under the restructured rules, the 2011 reform has increased the freedom of action as directors are now able to better motivate a lack of support for an offer with a large premium. It also constitutes a reminder for directors to *de facto* consider long-term interests.

10.4 The Cadbury takeover – a catalyst of change

The current U.K. takeover regulation is a result of the reforms that were introduced in the aftermath of the takeover of the British confectionary company Cadbury by Kraft in 2010. The Cadbury takeover exemplified the issues of regulating the target board's duties during takeovers and the reform had several effects on the target board's fiduciary duties and freedom of action in response to a takeover. Before launching a successful offer at £11.9 billion supported by the recommendation of Cadbury's board there had been two offers from Kraft, neither of which had gained the support of the board. The initial offers were rejected by Cadbury's board on the basis that the offers undervalued the company. Furthermore, the board held that shareholders would benefit from Cadbury remaining independent as the company had delivered outstanding performance in previous year and that the performance would provide the foundation for the realization of Cadbury's long-term goals.[140] Yet, a few days later, the board recommended Kraft's third bid, which, beside from the higher share price offered, had not changed from the previous two bids. The Cadbury board held that they had no other choice than recommending the bid as they now considered it to be in the best interest of the shareholders. It was later argued that the majority of shareholders in the

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[139] Kershaw 2012 p. 306.

[140] Cadbury's Board Statement, Second Response Document to Cadbury's investors (14 January 2010), p. 2-3.

company preferred short-term gains over longer-term prosperity and that the boards duty towards the shareholders was therefore to obtain the highest bid possible without considering long-term goals and future prospects.[141] Noticeably, in the time leading up to the bid the share price of Cadbury rose as the first signs of an imminent acquisition started to show. Shareholders who had been with Cadbury through the financial crisis saw an opportunity to exit and the ownership structure of Cadbury progressively changed. Long-term investors that had started disposing of their shares under previous management accelerated their exit in favor of short-term investors who saw an opportunity to profit on a possible takeover. Hedge fund ownership increased from 5 percent to 31 percent and when Kraft launched their bid, North American investors held a larger stake in Cadbury than their U.K. counterparts. The Cadbury board's decision to support the financially improved offer was therefore a reflection of the short-term shareholders own investment strategies. The surprising turn of events enraged the British public as a British crown jewel had been allowed to slip into the hands of foreign investors, disregarding what the change of control could mean for the future of the company and British interests therein.

10.4.1 The 2011 reform

The U.K. takeover regime underwent substantial changes in September 2011, when the reform to the Takeover Code formally proposed in March 2011 by the Code Committee entered into force. The debate following the Cadbury takeover focused on the need to protect British companies from foreign hostile takeovers and it was argued that the U.K. takeover regulation allowed companies with short-term investors to be taken over easily. Furthermore, it was held that the current regulation did not promote long-term ownership and activism.[142] Instead, directors tended to act more like auctioneers by recommending any bid that offered a premium to the current share price,

[141] R Carr, "Cadbury: Hostile Bids and Takeover", speech at Saïd Business School, Oxford (15 February 2010).

[142] Lord Mandelson, speech at Manor House, London, 1 March 2010.

disregarding the company's long-term interests and implications of the takeover.[143] The U.K. Takeover Panel was prompted to review the U.K. takeover regulation and found that a majority of directors in the U.K. market shared the misconception of the Cadbury board that the determining factor when evaluating a bid is the offer price alone.[144] The Takeover Panel therefore amended rule 25.2 of the Takeover Code as to clarify that the target board, when evaluating an offer, is not required to consider the offer price as the determining factor and is not precluded from taking into account other factors it considers relevant. In the reform process, the Code Committee also found that deal protection arrangements appeared to be "typical" in transactional practice. It was held that there was a need to restrict the use of deal protection arrangements to promote shareholder value.[145] The Code Committee proposed restrictions as such clauses were becoming market standard in the U.K. which could result in target boards being pressured into accepting deal protection arrangements. It was argued that this would undermine the target board's negotiating position, deprive target shareholders of the possibility to decide on the merits of a bid and deter competing bids.[146] About a third of the Code Committee's interviewees expressed concerns that a prohibition may deter initial offerors as the possibility for an offeror to guarantee coverage of their takeover costs would be limited.[147] Although in agreement, the Code Committee held that the deterrence and lock-in effect of deal protection arrangements were equally detrimental to target shareholders and adopted the prohibition with the support of the majority.[148] The end product prohibits

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[143] The Takeover Panel Code Committee, Response Statement to the Consultation Paper on Review of Certain Aspects of the Regulation of Takeover Bids, 2010, RS 2010/22, p. 3

[144] Ibid, Section 5.

[145] The Takeover Panel Code Committee, Review of certain aspects of the regulation of takeover bids, 2010, Consultation Paper Issued by the Code Committee of the Panel PCP 2010/2.

[146] Ibid, p. 81. For a more detailed discussion on the effects of break fees, see Chapter 12.

[147] Patrone (2011) p. 80 ff.

[148] The Takeover Panel Code Committee, Review of certain aspects of the regulation of takeover bids: Proposed amendments to the Takeover Code, Consultation Paper Issued by the Code Committee of the Panel PCP 2011/1, Section 3.

break fees and several other protective arrangements that were identified in the process and at the time constituted a break from the generally adopted approach in most developed markets, including the U.S.

10.4.2 Issues with the 2011 reform

The Code Committee held that the reform was justified to protect U.K. companies from being taken over too easily by hostile acquirers. To support this notion, statistics regarding hostile takeovers in the U.K. were presented. The statistics showed that in the four previous years, 472 offers were made of which 6 percent resulted in a successful hostile takeover, averaging seven a year.[149] Seven successful hostile takeovers a year in an otherwise active transaction market must rationally be considered quite a few. No other tangible evidence was presented to support the notion that it was too easy to succeed with a hostile takeover in the U.K. Despite the statistics, the Code Committee held that the Takeover Code put U.K. target companies in an inferior position to the offeror at the expense of target shareholders.[150] Furthermore, it was not explained how target companies' unfair disadvantage in takeover negotiations actually disadvantaged target shareholders.[151]

The Takeover Code's primary purpose is to ensure fair and equal treatment of shareholders and provide shareholders with the opportunity to decide on an offer. The target board's proposedly weak negotiating position may result in the board recommending a sub-optimal bid. Seeing as the target board's recommendation is an important variable in the shareholders decision to accept or decline an offer this may constitute an issue. However, if shareholders consider that a higher premium is likely to have been offered, they will decline the offer and refer it back to the negotiation table where the target board will have a better standing to negotiate an improved bid. If the

[149] The Takeover Panel Code Committee, Response Statement to the Consultation Paper on Review of Certain Aspects of the Regulation of Takeover Bids, 2010, RS 2010/22, Section 4.

[150] Ibid, Section 3.

[151] As the interests of the directors and the shareholders may diverge.

shareholders find the offer acceptable, it must be held that the recommendation was in the interest of the shareholders. A shareholder may very well have been awarded additional value if the target board had had a stronger negotiating position but the ultimate decision rests with the shareholder. An acceptance of the offer must be regarded as an expression of the shareholder's satisfaction of the terms in the circumstances. Additionally, a stronger target board is not necessarily desirable. Even if the interests of the shareholders and directors are aligned a possible entrenchment of the board could disincentivize potential bidders or encourage inferior hostile tender offers that may not have been realized if the target board had been approached first. Furthermore, the Takeover Code requires all shareholders to receive equal consideration for their shares and further protective provision like mandatory bidding requirements should negate any significant advantages of an offeror. Without further evidence it is unclear how the advantage of an offeror would have any significant impact on shareholders. It could be argued that a target board's stronger negotiating position would promote deals with better terms and higher premiums for shareholders. However, a recommendation of an offer that may have been higher under a stronger target board does not conflict with the interest of the shareholders per se.

The reasoning of the Code Committee can further be questioned in the light of the actual events of the Cadbury takeover. The Cadbury board negotiated a friendly acquisition after assessing the sentiment amongst shareholders. The majority of shareholders were prepared to accept the third bid as they considered that the premium offered from Kraft provided more value for their shares than a continuation of Cadbury as an independent entity. If the majority of shareholders wished for Cadbury to remain an independent British entity or that the long-term value increase was greater than the offered premium, they would most likely have declined the offer. Recommending the third bid was evidently in the interest of a majority of the shareholders. Although, the apparent short-term interest of the Cadbury shareholders may have diverged from that of the public and other critics who supported the reform, it was nonetheless the interest of the affected shareholders. Thus, looking to the actual events of the Cadbury takeover, the Code cannot be said to have given

Kraft an unfair advantage that negatively affected the Cadbury shareholders. The purpose of the Takeover Code is to protect shareholders, not to further protectionist interests or strengthen the position of stakeholders. The reform of the Takeover Code seems to have been initiated in a response to the public outcry and pressure from media and influential stakeholders and the arguments put forward to justify the reform are doubtful. The values that the Code Committee sought to protect by amending the Takeover Code are without a doubt worth protecting. However, the Takeover Panel should, looking to the purposes of the Takeover Code, be focused on ensuring fair treatment of shareholders. Socioeconomic factors and regulation of foreign investment should not be integrated in the takeover regulation but left to other areas of the law. Seeing as the reform may not have benefitted shareholders to a desired extent, one needs to examine the actual effects. The earlier depiction of deal protection arrangements in the thesis clearly shows that there are some uncertainties as to the shareholder benefits of deal protection arrangements. The actual effects the prohibition has had on shareholders of U.K. companies is consequently of great interest to the matter.

10.4.3 Market effects of the U.K. prohibition

The regulatory change of 2011 provided a unique opportunity to examine the effects of deal protection arrangements on target shareholders. Although the subject has been discussed in literature and predictions regarding the effects of deal protections have been made, little to no empirical evidence on the causal effect of deal protection regulation existed. Using a database of public-company M&A deals in the U.K. and a control group of other European G-10 countries between 2000 and 2015, Restrepo and Subramanian have studied the effects of the 2011 reforms in the U.K. Deal volumes, the incidence of competing offers, deal jumping rates, deal premiums and completion rates are examined relative to the European control group.[152] The control group was chosen due to the regional proximity and economic comparability and all deals announced between January 1, 2000 and December 31, 2015 in the

[152] Restrepo & Subramanian (2016).

relevant countries were used for the analysis.[153] During this time, and in most cases at the time of writing,[154] most other western European countries permit deal protection arrangements such as break fees although these are usually subject to constraints such as out-of-pocket restrictions and often required to be in the interest of the target shareholders.[155] During the relevant time frame, it was not market practice to utilize break fees on M&A transactions in France, Germany, Hungary, Belgium and Luxembourg while in the Netherlands and Spain, break fees were used but typically limited to one percent of deal value. The approach of the majority of countries in the control group was therefore one closer to the post-2011 approach in the U.K. than the more tolerant U.S. approach.[156]

Restrepo and Subramanian's findings suggests that deal volume in the U.K. decreased after the 2011 reform relative to the control group. Before the reform, about 50 percent of all deals in the sample[157] involved U.K. target companies whereas the same proportion fell to 34 percent after the reform. Additionally, the ratio of the mean number of deals to listed companies in the U.K. to the control group decreased by roughly 50 percent of the same ratio before the reform.[158] Before the reform, the total number of transactions as a whole as well as deals to listed firms in the U.K. and in the control group followed a similar trajectory. In the first quarter of 2011 after the reform, a significant and noticeable difference between these trajectories can be seen as the deal volume in the U.K. significantly decreased compared to that of the control group.[159] Although the relative number of deals decreased there was no substantial post-reform deviation in the incidence of competing bids, deal jumping, deal premiums or completion rates in the U.K. compared to the

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[153] Restrepo & Subramanian (2016) p. 8.

[154] Some countries have amended their national takeover legislation. For example, Rule II.17a of the Swedish Takeover Rules was introduced in 2016.

[155] Restrepo & Subramanian (2016) p. 3.

[156] Ibid.

[157] Deals announced in the U.K. as well as in the control group.

[158] Restrepo & Subramanian p. 11.

[159] See Figure 1, Panel A, Restrepo & Subramanian (2016).

control group.[160] Altogether, Restrepo and Subramanian's findings show a substantial and economically significant decline in deal volume. The total loss of deal value is estimated at USD 19.3 billion per quarter in the U.K. compared to the control group. With a hypothetical premium of 20 percent this implies that U.K. shareholders suffered a quarterly loss of USD 3.3 billion in the relevant post-reform time frame. Moreover, there seems to have been no obvious equipoising benefits to target shareholders such as higher premiums in completed deals due to enhanced conditions of competition.[161]

The results support the claim that potential offerors are deterred from launching an offer without being able to recover direct expenses and other costs in the case of an unsuccessful transaction. Discouragement or prohibition of deal protections promotes *ex post* competition at the expense of *ex ante* deal initiation. The research suggests that an initial offer is elastic to the initiating costs and that such costs should be acknowledged and accommodated by the takeover regulation. As concerns break fees the results show that a 1 percent break fee, as was allowed pre-reform, may generate a substantial increase in deal volume although it is unclear if deal volume increases linearly with the permissible break fee.[162] Restrepo and Subramanian argue that a 4-5 percent break fee, as have been upheld by U.S. courts, may be too high in relation to direct expenses and other costs of the offeror. Instead, they point to theoretical models that suggests an optimal break fee of 3 percent which has a deterring effect on potential competing bids but does not overcompensate an initial offeror.[163]

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[160] See Table 2, Panel B, Restrepo & Subramanian (2016).

[161] Restrepo & Subramanian (2016) p. 17.

[162] Ibid.

[163] Ibid.

11 Economic Research on Break Fees

11.1 Research

The use of break fees and other deal protection arrangements in public acquisitions varies in different jurisdictions. The use of deal protection arrangements is widespread in the U.S. and a majority of takeovers in the American market are subject to break fees.[164] Deal protection in the U.K. was market standard before the 2011 reform but have since decreased dramatically.[165] In public acquisitions in the Swedish market, there has never been a widespread use of deal protection. Still, a trend could be seen leading up to the Swedish prohibition as more transactions included deal protection, predominantly in takeovers involving American offerors.[166] There is little relevant research on the economic effects of break fees in the Swedish market due to the historically low prevalence of deal protection arrangements. The economic research presented therefore focuses on the U.K. market where the use of break fees was common practice before the 2011 reform and the American market where break fees remain market standard.

Research on break fees in the American market between 1989 and 1998 suggests that break fees benefit target shareholders through higher deal completion rates and larger premiums. The data indicates that the profit for target shareholders are larger than the losses due to the absence of a customary bidding process and that break fees serve as efficient contracting devices.[167] This conclusion is supported by Officer who demonstrates the positive correlation between break fees, higher premiums and success rates in the U.S. Officer's research show little evidence supporting the notion that break fees deter competing bids and his overall evidence indicates that the use of break

[164] Saulsbury (2012) p. 148.

[165] See Chapter 11.4.3.

[166] Stattin, Deal Protection och god sed på aktiemarknaden, p. 50.

[167] Bates & Lemmon (2003).

fees is beneficial rather than detrimental to target shareholders.[168] Subsequent research by Jeon & Ligon on break fee sizes provides additional support for the correlation between break fees and greater target shareholder value. Data collected between 2001 and 2007 in the U.S. provides evidence that fee size is generally positively correlated with deal completion but that break fees larger than 5 percent of deal value yield substantially lower premiums. The study also shows that low- or moderate- size fees does not eliminate *ex post* competitive bidding while fees larger than 10 percent do have a significant deterring effect. Small fee sizes actually increase *ex post* competition while moderate fee sizes have no significant effect. Low- or moderate size fees therefore appear beneficial to target shareholders while larger fees indicate agency problems.[169] The collective research on the American markets strongly indicate a correlation between break fees and target shareholder value maximizing up to a certain limit. There is a threshold beyond which break fees lose their beneficial properties, but reasonably sized break fees appear to benefit target shareholders by higher deal completion rates and larger premiums.

However, research on break fees in the Australian market indicates, contrary to the American findings, that break fees may have a negative effect on deal completion rates, premiums and shareholder returns in connection to the announcement of a bid. The authors themselves acknowledge that the finding that break fees have a negative impact on deal completion rates is not only at odds with theoretical models and U.S. research but also conventional wisdom.[170] A possible explanation to the result is that actors in the Australian market primarily use break fees in uncertain and particularly high-risk deals which are vulnerable to failure. Thus, misleadingly making it appear as if break fees reduces the chances of a bid succeeding.[171] During the research period, break fees were capped to 1 percent of deal value. In accordance with the findings of Jeon & Ligon, data on the Australian market shows that break

[168] Officer (2003) p. 456 ff.

[169] Jeon & Ligon (2011) p. 959 ff.

[170] Chapple et al. (2006) p. 25.

[171] Ibid.

fees limited to 1 percent of deal value did not deter competing bids.[172] This provides further evidence that there are no obvious agency problems in respect to low or moderate size break fees. Concerning the negative effects on premiums the authors suggest that the results may be contributable to the restrictions imposed by the Australian Takeover Panel, limiting the break fee to 1 percent of deal value. They argue that the 1 percent cap may be appropriate as to not deter competing bids but too low to properly incentivize bids from otherwise reluctant bidders.[173]

11.2 Findings and implications

The combined research suggests that break fees positively impact shareholder wealth and function as efficient contracting devices by improving deal completion rate and facilitating larger premiums. A prohibition of break fees is consequently not in the interest of target shareholders as fewer deals will be concluded and to a lower premium than in an unregulated market.[174] If the ambition when regulating takeovers is to protect target shareholders and maximize shareholder value, break fees should be allowed. However, as evidenced by the research, the beneficial properties of break fees seem dependent on the size thereof. Large break fees may have a deterring effect on *ex post* competitive bidding and yield lower premiums which, coupled with inherent agency problems, shows the need to limit break fees to protect target shareholders. These limitations must nevertheless be balanced and excessively intrusive regulation where break fees are allowed but capped too low is not desirable. Target shareholders may be deprived of potential wealth as diminutive break fees will not create enough incentive for an otherwise reluctant bidder to launch an initial bid or engage in a competitive bidding

[172] A break fee of one percent of deal value must be considered low in the context.

[173] Chapple et al. (2006) p. 26.

[174] Although it should be noted that there are undoubtedly issues regarding shareholder protection in completely unregulated markets as was evidenced in the U.S. in the 1980s, see Chapter 11.

process. The effect of break fees therefore is something in-between what can be predicted by agency theory and the efficient contracting theory.

The presented research supports the notion that excessive break fees are detrimental to shareholder value. It is therefore troublesome that the size of U.S. break fees has increased over the past thirty years in what is known in transactional practice as ''break fee or termination fee creep''.[175] Break fees have more than doubled in size since the 1980s from 1-2 percent of deal value to 3-4 percent by the 2000s.[176] However, beginning in 1999 Delaware courts began to address the permissible limits of break fees. A 6.3 percent break fee was held unreasonably large in Phelps Dodge v. Cyprus Amax Minerals Co., and a 5.5 percent break fee was recently considered to test the outer limits of reasonableness in Comverge Inc. Shareholder Litigation.[177] In the meantime, break fees around 4-4.5 percent has been upheld by the courts although considered quite high.[178] As a result of the increased involvement of the Delaware courts, the break fee creep has ceased. The actors in the market have been surprisingly susceptive to case law and break fees have leveled out just below the permissible percentages indicating that the use of deal protection is flexible and highly responsive.[179] The end of the break fee creep is positive as it favors a more open market for corporate control and more effective allocation of resources in the market. However, concerns are raised by Restrepo and Subramanian that the size of break fees may have plateaued at a higher level than what is desirable. They argue that a 1-2 percent break fee is sufficient to motivate first bidders and that the break fee creep was not motivated considering offerors' transaction costs during this period of time. The current size of break fees in the U.S. are therefore, according to Restrepo

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[175] Davidoff & Sautter (2013)

[176] Coates & Subramanian (2000) p. 336.

[177] Phelps Dodge Corp. v. Cyprus Amax Minerals Co., 1999 WL 1054255 (Del. Ch. 1999) & In re Comverge, Inc. Shareholders Litigation, Consol. C.A.No. 7368-VCP (Del. Ch. Nov. 25, 2014).

[178] See In re Topps Shareholders Litigation, 2007 WL 1732586 (Del.Ch. June 14, 2007) & In re Answers Corp. Shareholders Litigation, C.A. No. 6170-VCN (Del. Ch. Apr. 11, 2012).

[179] Restrepo & Subramanian (2017) p. 10.

and Subramanian, sub-optimal as the *ex post* negative effects on competition are likely to outweigh the *ex ante* benefits of deal initiation.[180]

[180] Restrepo & Subramanian (2017) p. 11.

12 Discussion and Conclusion

12.1 Economic analysis of rule II.17a of the Takeover Rules

Investments are necessary for company growth and potential investor returns. Without investment incentives, companies' access to venture capital, possibility of growth and subsequent returns would be eradicated. Market regulation affects individual companies, the business community at large and individual citizens as the impact thereof stretches beyond the confines of the market.[181] Overall economic welfare is contingent on the efficient allocation of resources on the market which requires effective competition. Minimal interference in the market would in theory yield the most efficient allocation of resources and in a seamlessly efficient market there is no need for regulation to facilitate competition or reduce transaction costs.[182] However, in addition to external factors, risk aversion and large transaction costs may negatively affect investment incentives and impede the efficient allocation of resources. Market regulation is consequently necessary to neutralize undesirable factors and maintain public trust in the stock market. If there are excessive transaction costs or market failure, there is a need for regulation. In accordance with the theory of minimal interference such regulation should be as non-intrusive as possible and designed to facilitate investments. In analyzing the Swedish prohibition of deal protection arrangements, one should therefore examine if the provision promotes the abovementioned desired market functions.

The permeating debate regarding deal protection arrangements, as is consistently demonstrated in the thesis, revolves around whether or not they are beneficial to target shareholders by promoting *ex ante* deal initiation and competing bids to a larger extent than it deters *ex post* competitive bidding.

[181] Sevenius (2017) p. 30.

[182] See Chapter 3.3.

The economic research suggests the former, although with caveats that should not be overlooked. The research on break fees in the U.S. and Australia indicates that break fees improve deal completion rates and provide target shareholders with larger premiums. However, the research also shows that the positive effects of break fees are relative to the size thereof. Reasonably sized break fees have been shown to promote competitive bidding and there is no evidence to suggest that such break fees deter competing bids. Excessive break fees may however have a negative impact on both premiums and deal completion rates. An absolute prohibition on break fees should therefore reduce the incentives for an offeror to launch a bid and result in fewer completed deals with lower premiums. Prohibiting the use of break fees effectively obstructs effective competition on the market and subsequent efficient allocation of resources, resulting in welfare losses. Yet, the negative effects of too large break fees necessitate restrictions to maximize market efficiency and safeguard target shareholder interests. While a cap on break fees of maximum 3 percent of deal value is held optimal, an American standard of 4-5 percent may prove too high in relation to an offeror's actual takeover cost. In contrast, smaller break fees may not promote deal initiation to a desired extent. Furthermore, as concerns deal protection arrangements in general, empirical evidence in the U.K. shows the negative impact a prohibition may have on deal activity and M&A transaction volume. Substantial declines in deal volume and loss of deal value suggest that discouragement of deal protections deter deal initiation and any hypothetical improvements to the competitive conditions in the market did not result in higher premiums for target shareholders. Accordingly, the motives behind prohibiting deal protection arrangements can be questioned when considering actual market effects.

12.2 The motives behind rule II.17a of the Takeover Rules

Rule II.17a of the Takeover Rules was introduced to strengthen the negotiating position of the target board, safeguard target shareholder interests

and create a more competitive takeover market. While the abovementioned research does not conclusively show that deal protections are beneficial to target shareholders in all circumstances, the introduction of the prohibition is remarkable. Not only is it questionable if a prohibition strengthens the target board's negotiating position, is beneficial to shareholders or promotes a competitive takeover market, but the motives behind rule II.17a can be questioned in themselves. The Swedish authorities openly proclaimed the prohibition a direct legal transplant from the U.K. To that end one must pose the question if the effects of the 2011 reform in the U.K. were thoroughly examined, the motives behind it properly evaluated and the differences between the capital markets in the U.K. and Sweden reflected upon.

The 2011 reform in the U.K. was not properly substantiated in regard to the proposed objectives. Firstly, no empirical evidence to support the notion that deal protections were predominantly detrimental to target shareholders was presented. Secondly, the statistics presented by the Code Committee did not support the view that U.K. companies were easy targets for hostile acquirers. Lastly, it was not shown how deal protection arrangements provided offerors with an unfair advantage in takeover negotiations and how this negatively affected target shareholders. Consequently, one can question the motives behind the reform as well as the end product in itself. Intentional or not, the overhaul of the U.K. takeover regulation has rather strengthened the position of stakeholders than target shareholders. Without a doubt, the U.K. takeover regime is in many aspects formidable and has historically functioned well and been in the vanguard of legal development. However, the 2011 reform may have been precipitous and misguided. Therefore, one can question the rationale of the Swedish endeavor to emulate the U.K. takeover regime in this respect. In my opinion, a U.K. type of prohibition was imported without fully considering how the rules would function in a different legal, social and political framework.

The ownership structure of Swedish publicly listed companies differs significantly from that of U.K. listed companies. Most listed companies in the U.K. have a dispersed ownership structure with coordinated and influential

institutional investors. Ownership in Swedish listed companies on the other hand is often concentrated with strong controlling shareholders and institutional investors play a comparatively less important role in the Swedish system. Controlling shareholders in Sweden often take an active ownership role and the real agency problem is not between directors and shareholders per se, but rather between majority and minority shareholders.[183] The acquisition of a company in a system with concentrated ownership structure is comparatively more expensive as controlling shareholders often hold a percentage higher than the threshold triggering a mandatory bid.[184] The increased acquisition costs may help a controlling shareholder to defend against an unwelcome offer and limit the contestability of control.[185] In certain circumstances the interest of controlling shareholders may not align with the presumed shareholder interest in the takeover context, namely that of maximum return on their investment in relation to the offer. Thus, an offer, financially beneficial for the shareholder collective or not, may be considered beneficial by a majority shareholder to the detriment of the minority. One may therefore question if the motives behind the U.K. reform are relevant to the Swedish system. The Cadbury takeover raised concerns that British companies were too easily acquired as institutional investors favoring short-term gains would sell when offered a premium high enough to satisfy their underlying investment strategies and third-party investors. Furthermore, it was argued that the Code did not promote long-term ownership and activism. Takeovers of Swedish listed companies are more difficult due to the presence of controlling shareholders and absence of widespread institutional ownership. Controlling shareholders are more likely to have long-term goals with the company and may entrench their position. However, if a controlling shareholder is willing to sell, he will most likely demand a substantial premium which, considering the mandatory bid rule, will make it considerably more expensive for an offeror to acquire control. It is consequently far-fetched to argue that Swedish companies are too easily taken

[183] Swedish Corporate Governance Board: The Ownership Role.

[184] See Article 5(1) of the Takeover Directive, an offeror will have to be prepared to purchase all outstanding shares to acquire control of the company.

[185] Ventoruzzo (2006) p. 140.

over or that the Swedish system discourages long-term ownership or an active ownership role. The adoption of a U.K. style of regulation may therefore have unforeseen consequences in the Swedish market.

The U.K. prohibition caused a substantial and economically significant decline in deal volume and the same effect may be seen in Sweden onwards. In my opinion, M&A activity in Sweden is likely to drop although the decline in deal volume should be comparatively less severe. Deal protections such as exclusivity arrangements and break fees were common and typical transactional practice in the U.K. before the prohibition. In Sweden on the other hand, deal protection arrangements have never been market standard, especially not in transactions between domestic parties. Transactions involving foreign offerors, predominantly American, accounted for the majority of deals where deal protections were used before the prohibition. Accordingly, it is reasonable to assume that deal protections were comparatively less important to deal initiation and completion in a majority of successful acquisitions in Sweden. Sweden is therefore less likely to experience an equally dramatic decline of M&A activity that transpired in the U.K. However, negative effects on the market appears inevitable and a progressive decline in foreign investment, mainly American, is not an unconceivable consequence of the prohibition. While the U.K. market's financial importance may encourage foreign offerors to accept additional costs and risks to remain in the market, it does not apply to the same extent to the globally less important Swedish market. Moreover, the U.K. market may prove more resilient to a decline in deal volume as well as loss of foreign investment than its Swedish counterpart. Regardless of whether the Code Committee in the U.K. surmised the negative effects of the prohibition it appears questionable if the Swedish decisionmakers did. On the face of it, the negative impact of the prohibition may not be of the same proportion as in the U.K. However, the actual economic effects may prove equally detrimental considering the more exposed Swedish market.

12.3 The increasing importance of irrevocables

An offerors inclination to mitigate the risk of an unsuccessful transaction will remain as long as takeover costs exist. Consequently, without the possibility of arranging deal protections, offerors will explore alternative methods to insure themselves against the risks associated with a takeover. It is questionable if the target board's negotiating position is strengthened in the absence of deal protection arrangements. Target boards' legal incapacity to offer assurances will most likely lead to offerors establishing direct contact with target shareholders to secure *ex ante* support of their bid through irrevocables. As offerors will seek additional security, the amount of hard irrevocables is likely to increase. A quantitative increase of irrevocables will in my opinion weaken the target board's negotiating position and have a negative impact on target shareholders in the Swedish system as offerors bypass the target board by irrevocable commitments. This raise concerns as the board and its directors are responsible for the day-to-day management of the company and should possess the most knowledge about the company and its future prospects. The directors on the board also owe their fiduciary duties to the company and the shareholders and are obliged to act in the interest of all shareholders under U.K., U.S. and Swedish law alike. Thus, in theory, the board is most suitable to negotiate a takeover and the most likely to secure an outcome that is beneficial for both the company and the shareholder collective. Although it should be noted that Swedish boards may be reluctant to counter the interest of a controlling shareholder due to their interest of future employment in listed companies. Irrevocables shifts the decision-making from the target board to individual shareholders who have no obligation to take any other interest than their own into account. In systems with dispersed ownership structures like the U.K. and the U.S. this may not prove as worrisome as in systems with concentrated ownership like Sweden. Obtaining sufficient shareholder support for a potential offer in a company with dispersed ownership will be more difficult, costly and time-consuming as the offeror must approach several shareholders and negotiate individual irrevocables. In a company with concentrated ownership on the other hand, it may be sufficient to obtain the support of a single controlling shareholder.

The final outcome is more likely to reflect overall shareholder interests when an offeror must secure the support of several shareholders. The interest of a controlling shareholder may not align with the interests of the remainder of the shareholder collective. This may be of particular concern in Sweden as dual-class voting shares are permissible and commonly occurring in Swedish publicly listed companies. A controlling shareholder may therefore in practice be able to decide on the outcome of a bid even though he does not suffer the bulk of the financial consequences or represent the quantitative majority of shareholders in the company. The decision to accept or reject a takeover is ultimately a question for the shareholders. However, in the absence of deal protections it may increasingly become a question reserved for majority shareholders.

A quantitative increase in irrevocables may also prove detrimental to the competitiveness of the takeover market and increase transaction costs. An offeror must disclose the extent to which he has received commitments to accept the offer from target shareholders in the announcement of the offer. Consequently, irrevocables may deter competing bids as potential offerors are discouraged from launching a competing bid in situations where there is strong support for the initial offer. Hard irrevocables may also restrict target shareholders possibility to accept a more beneficial competing bid, regardless of their willingness to do so. Deal protections may in fact neutralize the negative effects on competition that comes with irrevocables. A potential offeror is more likely to launch a competing bid if he can improve the likelihood of a successful transaction or insure himself against futile costs by using deal protections. Therefore, it appears that competitive conditions on a market where irrevocables are frequently used may in fact be improved by allowing deal protection arrangements. Moreover, irrevocables increase transaction costs on the market as offerors will have additional costs to contact target shareholders and negotiate the terms of an irrevocable. Such costs will often be high in publicly listed companies as the costs of contact and contract will apply to each individual shareholder needed to obtain sufficient support of the offer.

12.4 Exemptions as a mitigating factor

It can be argued that the issues with prohibiting deal protection arrangements could be mitigated by exemptions, allowing for the use of deal protections in circumstances where it would provide additional shareholder value. However, a system which is reliant on the possibility of exemption to function properly is neither desirable nor appropriate as drafting efficient provisions is challenging. The Swedish provision where deal protections may be allowed if they promote competitive bidding is sub-optimal as there are situations where target shareholders could benefit from deal protections even if it would deter competing bids.[186] The U.K. provision where deal protections may be allowed if it is in the interest of target shareholders is similarly flawed as the interest of the shareholders varies and may be difficult to determine in a given situation.[187] The probability of being granted an exemption for more extensive deal protection arrangements like break fees seems limited in both jurisdictions and dispensation is rarely sought in the Sweden and the U.K. alike. Looking to available statistics, the possibility of exemption in the U.K. has had a limited positive impact and did seemingly little to mitigate the post-reform decline in deal volume. Moreover, relying on exemptions shifts the decision-making further away from the target company. The target board is better equipped to decide what is and what is not in the interest of the target company and its shareholders than a third party. Authorities like The Swedish Securities Council or the U.K. Takeover Panel cannot be considered suitable to evaluate whether an arrangement is in the interest of target shareholders as they lack sufficient insight into individual companies' dealings. A system dependent on the possibility of exemptions would increase the burden on the designated authority and require immaculate administration as any inadequacies in the handling of dispensation matters would impede the efficiency of the market. Furthermore, the need to seek authorization to use deal protections would increase transaction costs.

[186] See Chapter 9.2.

[187] See Chapter 11.3.

12.5 De lege ferenda

The introduction of rule II.17a of the Takeover Rules appears to have been precipitous, misguided and may have unforeseen consequences. Deal protection arrangements appear to not conflict with the interest of the shareholders in publicly listed companies, presuming the interest is one of maximum return on investment. Empirical research supports these notions by providing indications that deal protection arrangements such as break fees create shareholder value by improving deal completion rate and final premiums if allowed but properly regulated. The research also suggests that prohibiting deal protections in general deter *ex ante* deal initiation to a larger extent than it promotes *ex post* competitive bidding. Additionally, a prohibition may lead to more, and hard, irrevocable commitments which raises concerns regarding minority shareholder participation, higher transaction costs and worsened competitive conditions in the market. The possibility of being granted an exemption does seemingly little to mitigate the negative effects and does not appear to be an appropriate solution to the problem. In summary, indications suggest that rule II.17a of the Takeover Rules does little to improve competitive conditions, promote target shareholder value or strengthen target boards negotiating position. Instead, the provision may increase transaction costs and aggravate shareholder agency problems. Furthermore, the provision does not improve the efficient allocation of resources on the market as it may reduce investment incentives and impede effective competition. Consequently, the prohibition is sub-optimal and unwarranted as overall economic welfare would be improved under a less intrusive regulatory regime which would provide for a controlled use of deal protections.

In accordance with the notion that minimal interference in the market is desirable, prohibitive market regulation should only be warranted if it improves the efficient allocation of resources or otherwise fulfills certain purposes or safeguards interests considered worthy of protection by the legislator. Economic research suggests that the prohibition does not improve

the efficient allocation of resources and cannot conclusively be said to protect shareholder interest or mitigate issues that could otherwise justify market intervention. Therefore, a reversion to the previous regime where the use of deal protection arrangements was governed by rule II.17 of the Takeover Rules, albeit with some modifications, may prove more beneficial for Swedish shareholders.

Subject to rule II.17 of the Takeover Rules, target companies were allowed to commit to deal protection arrangements as long as the terms of the arrangements were lawful and in the interest of the shareholders. Deal protection regulation should aim to make sure that the benefits of deal initiation is not outweighed by the negative effects on competitive bidding. In order to ensure effective competition in the market, the regulator should strive to control the effects of deal protections instead of prohibiting them. As the impact of certain deal protections can be appraised, such arrangements should if possible be independently regulated to control negative market effects. For instance, research suggests that restrictions can be imposed on break fees to ensure protection of initial offerors without deterring potential competing bids to any significant degree. Break fees should in my opinion consequently be allowed but the size thereof limited. Restrepo and Subramanian argue that break fees should be restricted to 3 percent of deal value. This would most likely be sufficient to cover an offerors takeover costs in the Swedish market without overcompensating the offeror or deterring competing bids. The additional costs for a competing offeror are relative to deal value and should not deter competing bids to any significant degree as a potential competing offeror will only need to increase his valuation of the target company with a few percent. In addition to maximizing the return on investment, the Takeover Rules stipulate that shareholders are to be given the opportunity to decide on the merits of a bid. Consequently, it would be sensible to cap break fees at a slightly lower level than 3 percent of deal value to ensure minimum deterrence and that all shareholders are given the opportunity to decide on the merits of a bid.

Provided that the target board acts in the interest of the shareholders, relatively few problems should arise under the proposed regime. Yet this cannot always be presumed. Agency problems make it difficult to trust that directors are not affected by ulterior motives and that decisions to commit to deal protection arrangements are made in the interest of the shareholders. Furthermore, while empirical evidence indicates that deal protections provide shareholders with additional value there are difficulties in actually determining the interest of the shareholders. The interest of Swedish shareholders in a takeover context is that of maximum return on investment and the opportunity to decide on the merits of a bid. However, although profit maximization is held as the fundamental shareholder interest it may vary on a case-to-case basis and a general interest among shareholders cannot be established. As the shareholder interest is not constant it may be difficult for the target board to know how to properly act in response to an offeror in certain circumstances. Bearing in mind the presumed shareholder interest, deal protections should only be allowed if they provide target shareholders with maximum return on investment, the use thereof is consequently dependent on the offer itself. The target board must evaluate an offer to determine if it is beneficial to the shareholders and if deal protections would promote deal completion in the interest of the shareholders. The predicament here is one of defining the maximum return on shareholder investment; is it a matter of acquiring the highest premium possible in response to an offer or should the target board also take into account the future prospects of the company as an independent entity? This issue is particularly prominent when a target company is subject to an offer that provides shareholders with a fair premium, but additional value may be extracted by the continuation of the company as an independent entity. The predicament of choosing between short-term gains or longer-term prosperity was evidenced in the Cadbury takeover which in essence sparked the overhaul of the U.K. takeover regulation.

The fundamental issue with the proposed reversion is accordingly to determine if the commitment to a deal protection arrangement was in the interest of the shareholders or not. As it is not possible to define a constant

shareholder interest, the inherit agency problem will most likely lead to an intensified scrutiny of target boards decision-making under the proposed regime. Difficulties to determine the benefits of a particular deal protection arrangement may lead to increasing litigation if target shareholders consider themselves wronged by the arrangement. In the U.S., shareholder litigation in response to actions by the target board in takeover situations is facilitated by detailed and highly developed doctrines. The enhanced scrutiny under Unocal/Unitrin combined with the Revlon rule eases the plaintiff's burden and provides a measure of protection to the shareholders and the courts with an easily surveyable framework. Shareholder litigation is comparatively more common in the U.S. and the Delaware courts are highly competent and efficient in their handling of corporate cases. Legal action such as derivative suits is comparatively less troublesome, cheaper, more accessible and therefore more attractive for U.S. shareholders. In contrast, the burden of proof is placed on the shareholder plaintiff and the plaintiff must show a breach of the directors' fiduciary duties in Sweden. Not only is it exceedingly difficult for a shareholder to show a breach of fiduciary duties, it is also both time-consuming and costly. Swedish courts, relative to Delaware courts, should be less accustomed to complex corporate cases due to lower frequencies of such cases which may further increase the costs of litigation for shareholders. Accordingly, Swedish shareholders would not have the same opportunities as their American counterparts to protect their interests through litigation. Sweden could in my opinion benefit from a U.S. type of regulation in these cases. Incentives for shareholders to take legal action would increase if litigation costs were reduced by providing the courts with a more structured and easily surveyable framework for assessing target board actions in takeovers. Shareholder litigation would be facilitated which may mitigate some of the above stated issues. A Revlon-type approach may also prove useful when the target board is forced to choose between short-term gains and longer-term prosperity by regulating the situations wherein target boards are required to obtain the highest offer available. Deal protections should in these situations only be used to promote competitive bidding or secure the highest available bid that could reasonably be obtained in the circumstances.

The proposed revision would undeniably create new problems and place greater demands on the judiciary infrastructure. Additionally, situations may arise where it is not possible to determine if the target board has acted in the interest of the shareholders or not. However, these situations seem comparatively uncommon, and the negative effects of the current regime appear greater than those that may arise due to the proposed revision.

Regulation is required for the market to achieve its purpose and function properly which will inevitably lead to conflicts of interest and necessitate decisions of which interests should be given priority in certain circumstances. Deal protection arrangements cannot conclusively be viewed as a threat to market functions and a prohibition does little to mitigate information asymmetries, protect consumers, maintain public trust in the stock market or protect the integrity of the financial systems. It is also doubtful if prohibiting deal protections contributes to a more competitive takeover market and promotes target shareholder value to a greater extent than allowing them. Therefore, while the argument that a prohibition on deal protections is beneficial to shareholders cannot be entirely debunked, the merits thereof can certainly be questioned. Prohibitive regulation that interferes with the intrinsic function of the market should, when it is questionable if the regulation achieves its purposes, be evaluated on the basis of its actual effects.

The stock market is of utmost importance to overall social welfare. Regulation that furthers market development, promotes efficient allocation of resources, reduces transaction costs and maximizes economic welfare to the largest extent should be given precedence in the present circumstances. The shortcomings of the proposed reversion are in my opinion insignificant compared to the conceivably negative economic effects of the current prohibition. Market interferences and integral issues of the corporation necessitates regulation and when evaluating two different regimes the least intrusive should be favored. The proposed reversion is not flawless but, looking to the potential effects thereof, constitutes a reasonable compromise.

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