Facilitating the Optimal Mechanism in Mergers & Acquisitions: A Comparative Perspective from the Commonwealth and United States

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This paper attempts to identify the salient economic features of Mergers and Acquisitions (M&A) transactions that are relevant to the takeover regulation of publicly listed companies. While attainment of the optimal mechanism in every instance may not be possible, we have suggested general guidelines as to how takeover regulation should move towards the optimal mechanisms that are applicable given real-world assumptions. With efficiency as the appropriate normative yardstick, we suggest the removal of defensive measures, the removal of Revlon-type duties and the enforcement of ex-ante deal protection measures as simple reforms that would substantially improve a given takeover regime. This represents the state of Singapore law presently, which arguably has merged the best of the US and UK laws. The efficiency properties of the regime arise from the recognition of a "proper purpose rule". Simply put, in cases where the exercise of a power would affect the strength and relative positions within the company of different sections or classes of shareholders, we should consider whether or not the power in the hands of directors was properly exercised in accordance with welfarist standards. This balancing process is preferable in the takeover regulation context, where the use of "soft law" and flexible standards are administered by a market regulator; as opposed to the use of specific rules, which are better implemented by courts.

Keywords : *Takeover Regulation, Mergers and Acquisitions Transactions, Deal-protection measures, Comparative corporate law*

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I. Introduction

"The rise of corporate governance" in recent years has been well documented by numerous scholars.[1] Has this increase in attention to corporate governance led to any form of systemic convergence in corporate governance regimes around the world? In a compelling article, Gordon puts forth a nuanced narrative – while there has been convergence in many of the formal governance rules across law regimes the world over, local regimes continue to diverge considerably.[2] For example, Gordon argues that we continue to observe considerable differences in ownership structures. Despite many improvements in minority-shareholder protection, the Anglo-Saxon paradigm of diffuse ownership has not emerged as the predominant form of ownership structure across the globe.

The striking degree of divergence in the way that hostile takeovers are regulated across different jurisdictions is also observed, even amidst common law jurisdictions. Under Delaware takeover law, directors who decide to put their company up for sale must seek and obtain the best price for their shareholders. *Revlon* duties require the target company's board of directors to be placed in the shoes of "auctioneers charged with getting the best price for the stock-holders at a sale of the company".[3] In contrast, the position in other Commonwealth Takeovers Codes is more ambivalent. The directors' duties to shareholders imposed by these codes may simply be an enhanced one to treat shareholders fairly.[4]

In this article, we attempt to evaluate several comparative takeover regimes pursuant to a "welfarist" analysis.[5] Our benchmark is that of economic efficiency,

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1 See, for example Bebchuk, Alon, and Robert J Jackson Jr 'The Rise of Corporate Governance', available at SSRN 2853768 (2016); Netter, Jeffry, Annette Poulsen, and Mike Stegemoller, 'The Rise of Corporate Governance in Corporate Control Research' (2009) 15(1) Journal of Corporate Finance 1–9; and Cadbury, Adrian, 'The Rise of Corporate Governance' (2006) 1 The Accountable Corporation 3–44.

2 Jeffrey N Gordon, 'Convergence and Persistence in Corporate Law and Governance', *Oxford Handbook of Corporate Law and Governance* (Jeffrey Gordon & Georg Ringe eds, 2017). Compare MacNeil, Iain, 'Adaptation and Convergence in Corporate Governance: The Case of Chinese Listed Companies' (2002) 2(2) Journal of Corporate Law Studies 289–344 (greater convergence in securities laws).

3 *Revlon Inc v MacAndrews & Forbes Holdings Inc* 506 A 2d 173 (1986).

4 *Heron International Ltd v Lord Grade and Associated Communications Corpn plc* [1983] BCLC 244; *John Crowther Group plc v Carpets International plc* [1990] BCLC 460 ('duty' to obtain best price for present shareholders) but compare *Re a Company* [1986] BCLC 382, *Fulham Football Club Ltd v Cabra Estates plc* [1992] BCC 863; *Dawson International plc v Coats Paton plc* [1991] BCC 276 (allowing boards to recommend lower bids). See further Wan, Wai Yee, and Umakanth Varottil, *Mergers and Acquisitions in Singapore: Law and Practice* (LexisNexis 2013) ch 8.

5 By a 'welfarist' analysis, we are referring to the maximization of social welfare under a 'Kaldor-Hicks' framework or a 'Pareto optimal' framework. The notion of Kaldor-Hicks efficiency implies that after allowing for compensation between parties, the situation cannot be modified so as to make one individual (or preference criterion) better off without making at least one individual (or preference criterion) worse off. Pareto efficiency implies the same without the more expansive condition that compensation between parties is permitted. As such, Kaldor-Hicks efficiency

taking into account the effects of takeover law on the incentives of the stakeholders involved.[6] Our normative framework is natural in the context of corporate governance where efficiency considerations tend to be paramount, especially in the United States ("U.S.").[7] Indeed, ever since Jensen and Meckling's seminal work,[8] the minimization of agency costs amongst various stakeholders of the firm has been seen as a central objective of contemporary corporate law.[9] We compare and contrast three common law takeover regimes: Delaware law, the United Kingdom ('UK') (on whose laws those of many Commonwealth jurisdictions, including India, are modelled upon), and Singapore. We argue that Singapore's takeover regime emerges as the most efficient of these three jurisdictions. The intuition of our thesis stems from the fact that Singapore's takeover regime is *context specific*, and is thus best able to balance the various tensions involved in stakeholder regulation.[10] As we will explain later, among other reasons, takeover regulation has to balance an inherent tension between the ex-post allocative inefficiencies caused by the failure to allocate target companies to high-value potential acquirers, and the ex-ante investment inefficiencies resulting from the failure to induce acquiring bidders by reducing competition for target firms.[11] Given the hegemony of Law & Economics in U.S. corporate law scholarship,[12] our observations are somewhat surprising; and highlight an important role for comparative corporate law scholarship even where a common normative structure is assumed.[13]

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is a subset of Pareto efficiency, which has been said to be 'too demanding to serve as a useful norm in enterprise law' Allen, William T, and Reinier Kraakman, *Commentaries and Cases on the Law of Business Organization* (Wolters Kluwer Law & Business 2016) Introduction n 1. See also Markovits, Richard S, 'Second-Best Theory and Law & (and) Economics: An Introduction' (1997) 73 Chi-Kent L Rev 3.

6 See more generally Zerbe, Richard O, *Economic efficiency in Law and Economics* (Edward Elgar Publishing 2002).

7 See Bainbridge, Stephen M, 'Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship' (1997) 82(4) Cornell Law Review 856–1532. ('Over the last few decades, law and economics scholars have mounted a largely successful hostile takeover of the corporate legal academy.')

8 Michael C Jensen & William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure', (1976) 3 Journal of Financial Economics 305.

9 The 'purpose of the firm' is a subject of heated debate, and some scholars opine that corporate law should pursue pluralistic objectives that protect the corporation's non contractual stakeholders. See Stout, Lynn A, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Berrett-Koehler Publishers 2012). However, we adopt the more orthodox position that the protection of interests extraneous to the firm should come from other areas of law, such as environmental law, human rights law, antitrust law, or financial regulation. Furthermore, scholars have noted that such an approach may allow corporate law to 'become an easy target of populist or misguided reform efforts that can easily decrease the efficiency of its regime without generating any meaningful gains for other constituencies'. See Kraakman, R et al, *The Anatomy of Corporate law: A Comparative and Functional Approach* (Oxford University Press 2017) 93.

10 Infra Part 5.

11 Infra Parts 2 and 3.

12 Bainbridge (n 7).

13 By 'normative structure', we are making reference to the normative framework we adopt in this article – economic efficiency (under a 'Kaldor-Hicks' framework). *Cf* Rock, Edward B, 'America's

Two key arguments are thought to justify *Revlon* duties. The first is that a company's managers should maximise the value of their shareholders' investment in the company.[14] In the context of takeovers, a target company's managers should thus sell the company at the highest price possible. This premise follows from the fact that shareholder value maximization generally results in *social efficiency*, so long as the maximisation process is *constrained* by exogenous law where externalities result from it.[15] For example, a profit-maximizing firm[16] may choose to engage in activities that have a detrimental impact on the environment, indirectly raising the value of its shareholders' investment at the expense of the public. Where appropriate, such conduct should rightfully be restrained by environmental regulation.[17] In the absence of such externalities, shareholder value maximization tends to reduce agency costs between managers and shareholders, increasing both shareholder value and social welfare – aligning both objectives of revenue maximization and welfare maximization.[18] However, as we will explain later in our article, informational externalities in takeovers may preclude such alignment, forcing regulators and courts to consider the trade-off between both objectives.[19]

The second argument is that auctions provide the most efficient *means* of selling companies in takeovers. An auction is a sales event wherein potential buyers place competitive bids on one or more assets for sale.[20] When compared to other mechanisms of sale (such as private negotiations and lotteries),[21] it may be argued that auctions are optimal in maximising shareholder returns.[22] As the target company is sold to the highest bidder, auctions are generally seen as *allocatively efficient* devices because the target's assets are ostensibly allocated to the

Shifting Fascination with Comparative Corporate Governance' (1996) 74 Wash ULQ 367. ('Unless German managers are motivated by the same things that motivate American managers, there is little reason to believe that the normative structures of German corporate life have very much to say to America.')

[14] Kraakman (n 9).

[15] Kraakman (n 9).

[16] The maximization of shareholder value follows from profit-maximization in the firm's product markets, with the latter being a strong factor in eventuating the former. See Rotemberg, Julio J, and David S Scharfstein, 'Shareholder-Value Maximization and Product-Market Competition' (1990) 3(3) The Review of Financial Studies 367–391.

[17] In other words, any claim that relates to the 'maximization of shareholder value' should not amount to a substantive defense in environmental law.

[18] Jensen and Meckling (n 8).

[19] Infra Parts 2 and 3.

[20] See Krishna, Vijay, *Auction Theory* (Academic Press 2009).

[21] In Mechanism Design, a 'mechanism' is an allocative device that allocates objects pursuant to an economic agent's 'type' (eg whether a buyer has a high or low valuation for the object). Auctions are examples of mechanisms since they allocate a scarce object in accordance with the valuations of participating economic agents. See ibid.

[22] By 'optimal', we refer to (Kaldor-Hicks) efficiency, or welfare maximization as a normative yardstick, although we consider revenue maximization to be a relevant yardstick as well. More generally, unless otherwise stated, we use 'efficiency', 'economic efficiency', 'Kaldor-Hicks efficiency', and welfare maximization as synonyms for each other throughout our article. Infra Part 2.

highest-valuing acquirer amongst a pool of potential acquirers.[23] However, this proposition is dependent on numerous assumptions which may not hold true. For example, the efficiency properties of a given auction only follow from the premise that *all* potential acquirers *participate* in the said auction.[24] As we will explain later, in the takeover setting, acquirer participation cannot be guaranteed. Indeed, numerous commentators have suggested that auctions reduce incentives to search for mismanaged companies,[25] and that auctions reduce *ex ante* acquirer participation,[26] thereby causing auctions to be welfare-inferior to other mechanisms of sale.

If auctions are not the most efficient means of selling a company, what then, is the superior mechanism for the sale of public companies? Unfortunately, there is no clear consensus in the existing economic literature. Indeed, the "optimality" of *any* mechanism of sale turns on the empirical validity of the underlying assumptions establishing the efficiency of the said mechanism.[27] Essentially, this means that the efficient mechanism is context-specific, and ultimately depends on the facts at hand. However, the argument that policymakers have little to no guidance in determining the appropriate policy response in a given case is a bold claim that perhaps goes too far. By examining the characteristics of the *typical* transaction subject to takeover regulation, we are able to make arguments as to why certain policies should be favoured over others.[28] Furthermore, it is not clear that a "one size fits all" approach is appropriate in relation to takeover regulation.[29]

In this article, we argue that general duties to seek the best sale price for shareholders, such as those imposed by *Revlon,* are overly inclusive and thus induce inefficiency in many cases. As such, we posit that the flexibility accorded by UK-style Takeover Codes may be preferable. This flexibility is captured by the "proper purpose rule".[30] The crux behind the efficiency properties underlying the "proper purpose rule" stems from the fact that it is *context-specific*. Such context-specific standards involve a duty on the part of the target directors to "act

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[23] Krishna (n 20). See also Gilson, Ronald J, 'Seeking competitive bids versus pure passivity in tender offer defense' [1982] Stanford Law Review 51—67.

[24] Kahan, Marcel, and Michael Klausner, 'Lockups and the market for corporate control' (1995) 48 Stanford Law Review 1539.

[25] Schwartz, Alan, 'Search theory and the tender offer auction' (1986) 2 JL Econ & Org 229.

[26] Che, Yeon-Koo, and Tracy R Lewis, 'The role of lockups in takeover contests' (2007) 38(3) The RAND Journal of Economics 648—669.

[27] See generally Friedman, Milton, and Marilyn Friedman, *Essays in Positive Economics* (University of Chicago Press 1953).

[28] See Kaplow, Louis, and Steven Shavell, 'Accuracy in the Determination of Liability' (1994) 37(1) The Journal of Law and Economics 1—15.

[29] More generally, see Davies, Marlene, and Bernadette Schlitzer, 'The impracticality of an international "one size fits all" corporate governance code of best practice' (2008) 23(6) Managerial Auditing Journal 532—544.

[30] See eg RC Nolan, 'The Proper Purpose Doctrine and Company Directors' in BAK Rider (ed) *The Realm of Company Law* (Kluwer Law International 1998) 1.

fairly" in relation to the shareholders whilst being heavily guided by the regulatory authorities, whom are themselves drawn from market professionals,[31] in fashioning an efficient, if not the most efficient, outcome. This may or may not involve an auction. The regulator's decisions are subject to judicial review, but cannot be appealed on the merits. We suggest that this approach allows regulators to countenance agreements between target companies and potential acquirers where such agreements are efficiency-enhancing.

The paper is organized as follows. In Part 2 of our paper, we elucidate some important definitional concepts concerning the disparate objectives of revenue maximization and efficiency. In Part 3 of our paper, we identify the salient economic features of M&A transactions that are relevant to takeover regulation. In Part 4, we suggest general guidelines as to how takeover regulation should move towards the optimal mechanisms that are applicable given real-world assumptions. With efficiency as the appropriate normative yardstick, in Part 5, we suggest the removal of defensive measures, the removal of *Revlon*-type duties and the enforcement of certain ex-ante deal protection measures as simple and workable reforms that would substantially improve the efficiency of takeover regimes. We will see that this is in effect the present position in Singapore.

II. Definitions

Two conceptions of efficiency are important for takeover regulation. In this section, we attempt to elucidate these distinct concepts, before discussing the relationship between these concepts of efficiency and revenue maximization. While revenue maximization may lead to allocative efficiency, the former does not necessarily entail a broader notion of efficiency encompassing both investment and allocative efficiency. This provides us with normative grounds to critique Revlon-type duties in Part 5 of our article.

A. Allocative vs Investment Efficiency

Allocative efficiency represents the *optimal* distribution of goods and services in a particular market.[32] Under allocative efficiency, goods and services under allocative efficiency are allocated and distributed to their *best use* – there is no other distribution that exists which would produce superior outcomes.[33] In the

[31] See John Armour, Jack B Jacobs, and Curtis J Milhaupt, 'The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework' (2011) 52 Harvard International Law Journal 2019.

[32] Gode, Dhananjay K, and Shyam Sunder, 'What makes markets allocationally efficient?' (1997) 112(2) The Quarterly Journal of Economics : 603–630. See also Cooter, Robert, and Thomas Ulen, *Law and Economics* (Addison-Wesley 2016) 108. ('allocative efficiency [is achieved] by moving goods from people who value them less to people who value them more').

[33] ibid.

context of takeovers, allocative efficiency mandates that firms are allocated to the highest-valuing acquirer amongst *all* potential acquirers.[34] In contrast with investment efficiency, allocative efficiency is a *static* concept, and does not consider the incentives of market participants across time.[35] Allocative efficiency is especially important where acquirers have differing valuations for the same target firm.[36]

On the other hand, investment efficiency[37] is a concept derived from the law and economics of property rights. It denotes a scenario where one or more parties continue to invest in a particular activity until the marginal benefit from that activity is equal to the marginal cost from the same.[38] Investment efficiency recognizes that the optimal use or creation of property rights may require some investment by its owners, and so necessitates some pecuniary return for the investors to induce these investments.[39] In the takeover setting, investment efficiency requires that potential acquirers invest in the costly discovery of their valuation of a potential target firm.[40] In the absence of such investments, publicly available information may be insufficient to induce a takeover bid. In this scenario, allocative efficiency would not be attained. Investment efficiency is thus a *dynamic* concept – it considers the *ex ante* investment incentives of market participants prior to any allocation of resources.[41]

The trade-off between allocative and investment efficiency arises because socially optimal investments are costly, and so may necessitate some pecuniary return to induce such investments in the first place. Unfortunately, the presence of these pecuniary returns may assume the form of the reduction or elimination of competition, thereby reducing allocative efficiency.[42] Hence, in takeovers, a potential acquirer may wish to protect its investments in value-discovery by preventing rival acquirers from competing with it for the target firm after such investments are made. A broader notion of social (Kaldor-Hicks) efficiency would

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[34] Krishna (n 20).

[35] Gode and Sunder (n 33).

[36] Infra Part 3.

[37] Investment efficiency is also known as 'dynamic efficiency'. In this article, we use both terms as synonyms for each other.

[38] Cooter and Ulen (n 33) 144. ('Social efficiency requires investors to invest in a resource until the marginal cost equals the marginal increase in productive value.')

[39] Indeed, this provides the traditional justification for the existence of intellectual property rights. See Cooter and Ulen (n 33) at 116. ('When intellectual property rights are effectively enforced, the owner of a new computer chip or novel can use the power of exclusion to extract a price from other users. The price rewards the creator, which results in more innovations and faster growth—a form of 'dynamic efficiency.')

[40] Infra Part 3.

[41] Cooter and Ulen (n 33) 116.

[42] This trade-off is well established in Intellectual Property Law. See Cooter and Ulen (n 33) 117. ('Increasing incentives for creation also increases incentives for dissemination, at least up to a point. Beyond this point, however, broadening the scope or duration of the creator's property rights increases monopoly power, which rewards creation and reduces dissemination. Thus, incentives for creation and dissemination trade off.')

thus consider the optimal trade-off between both notions of efficiency. Ideally, the total welfare gains from an increase in investment efficiency from a given restriction of competition should outweigh the reduction in allocative efficiency resulting from the same.

B. Revenue Maximization vs Efficiency

By definition, economic efficiency implies the maximisation of social welfare.[43] In contrast, revenue maximisation in a given transaction does not necessarily imply the latter. Indeed, while monopolistic pricing in product markets is clearly allocatively inefficient, it stems from the revenue-maximizing conduct of a monopolist.[44] Accordingly, the relationship between the objectives of revenue maximization (in the sense of shareholder value maximization)[45] and social welfare maximization (efficiency) are not immediately obvious.

To see how the two concepts are somewhat related, consider the paradigm situation of inefficiency *within* a given firm. Consider the internal organisation of a typical incorporated firm. The separation of ownership and control within the firm[46] entails that the managers of the firm (known as "agents") are able to make decisions that impact the firm's shareholders (known as "principals").[47] However, the managers of the firm have divergent interests from that of the shareholders – they wish to maximize their own well-being, not that of their shareholders. In a setting of information asymmetry, the shareholder principals are unable to ensure that their agent managers are always acting in their best interests, especially when activities that benefit the shareholder are costly to the managers– for example, when the level of "effort" on the part of managers would affect firm profits and by extension, share prices.[48] Where shareholders are unable to align their interests with that of their managers, they may simply reduce their ex-ante investments in the firm to begin with, thus reducing welfare relative to a counterfactual where

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[43] (n 23).

[44] Varian, Hal R, *Intermediate Microeconomics with Calculus: A Modern Approach* (WW Norton & Company 2014) 445–449.

[45] Rotemberg and Scharfstein (n 16). Note that we use 'revenue' as a term equivalent to shareholder value here. Care must be taken as revenue is usually linked what is generated by the company's underlying business whereas the share price is determined by the forces of supply and demand for the shares, and revenue in that context can simply be increased by decreasing the supply or increasing the demand for those shares. Further the seller in the context of takeovers is an individual shareholder itself but for the purposes of discussion here can also be the target company in a sense making a collective decision for all the shareholders. See Jarrow, Robert A., Philip Protter, and Kazuhiro Shimbo. 'Asset price bubbles in incomplete markets.' *Mathematical Finance: An International Journal of Mathematics, Statistics and Financial Economics* 20, no 2 (2010): 145–185. Selling substantially all the assets of a company can be seen as the equivalent of shareholders selling their shares: *John Crowther Group plc v Carpets International plc* (n 5).

[46] Jensen and Meckling (n 8).

[47] See also Bolton, Patrick, and Mathias Dewatripont, *Contract Theory* (MIT Press 2005).

[48] Bolton and Dewatripont, ibid; Jensen and Meckling (n 8).

shareholder-manager interests are aligned.[49] The aforementioned divergence of managerial interests from shareholder interests is a fundamental issue that corporate governance and corporate law attempts to address. Costs incurred to align these interests have been termed as "agency costs".[50]

In the context of takeovers, the goal of revenue maximization entered the law through takeover litigation, where the question for the court was often whether the target board fulfilled its fiduciary duty towards its shareholders by maximizing revenue in a sale. More subtly, however, such a fiduciary duty would reduce agency costs between target managers and shareholders, thereby increasing social welfare.[51] To see why, consider a legal regime without such a duty. In such a regime, self-interested managers would exert little to no effort advocating for shareholder interests in the event of a firm sale. Furthermore, notwithstanding the fact that managers of the firm enjoy an informational advantage over shareholders, they would have little to no incentives to disclose relevant information to potential acquirers of the firm. Knowing this, rational shareholders would discount the value of their ex-ante investments in the firm accordingly, reducing allocative efficiency.

While revenue maximization has the ostensible benefits described above, it also has attendant costs. In particular, revenue maximization can cause social inefficiency where information asymmetry is present between transacting parties.[52] For example, in product markets, the revenue-maximising conduct of a monopolist (lacking information over its customers' valuation of its products) results in a lower equilibrium output. Essentially, the increased revenue from charging a higher price outweighs the associated decreased revenue from lost sales, as the gain in revenue from infra-marginal customers who pay higher prices outweighs the losses in revenue from marginal customers who no longer purchase the product.[53] Indeed, similar intuition also applies to the sale of a single object under an auction, where the revenue-maximising auctioneer finds it profitable to introduce

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[49] ibid.

[50] ibid.

[51] Cf Peter Cramton, and Alan Schwartz, 'Using auction theory to inform takeover regulation' (1991) 7(1) Journal of Law, Economics, & Organization 27–53, who take the harsher view that 'The revenue maximization goal entered the law because of the way takeover litigations are conducted, but has no intellectual support'.

[52] Although the inefficiency also arises here from information asymmetry, note that this is a different form of inefficiency as compared to the 'moral hazard' form of inefficiency *within* the firm where the incentives of the agent diverges from that of the principal (see Jensen and Meckling n 8). Here, the transaction occurs because the firm cannot fully extract surplus from its transacting parties despite its market power, and so pays an 'information rent' by reducing the probability or quantity of trade. If the firm had perfect information over the valuation of its counterparties, it would perfectly price discriminate, and so trade would not be restricted. See Varian, Hal R, 'Price Discrimination' in *Handbook of Industrial Organization* (North-Holland Press 1989) 597–654.

[53] Varian (n 44).

a reserve price that decreases the probability of an efficient transaction.[54] In the setting of takeovers, reserve prices take the form of defensive measures adopted by firm managers in response to a proposed firm sale. In Part 5 of our article, we suggest the removal of such discretion from directors as it can be seen as an improper exercise of powers given to them in managing a company.

The inefficiency from revenue maximisation also arises from externalities, where the welfare of a third party is affected by a given transaction between two or more transacting parties.[55] As noted in Part I of our Article, revenue maximisation leads to beneficial welfare effects by increasing efficiency *within* the firm, but not outside of it.[56] Thus, revenue-maximizing conduct often leads to social inefficiency where firm choose to engage in activities that have an effect on third parties. It is important to note that the nature of the externality may be positive or negative; that is, it may increase or decrease the welfare of the third party.[57] As we will explain later, informational externalities in takeovers may discourage socially beneficial *ex ante* investments in value discovery.

In the setting of takeovers, problems associated with revenue maximization are somewhat ameliorated if the subsequent *resale* of a given target firm is not itself costly. Consider the sale of a single firm through an auction. If there are unrealized gains from trade, the winner of the auction can simply resell the firm to another acquirer who attaches a higher value to the firm, so allocative efficiency is ultimately unaffected. However, as Krishna argues, this argument is suspect for many reasons.[58] Post-auction transactions typically involve negotiations and bargaining amongst a small number of agents, thereby often resulting in inefficient outcomes if they take place under conditions of incomplete information.[59] Essentially, if resale involves significant transaction costs, it might not take place even if it should.

As Cramton and Schwartz note, the right question for takeover regulation is "which takeover mechanisms advance the common good".[60] Thus, revenue maximization should not be taken as a normative objective of takeover regulation *per se*, as it has both attendant benefits and costs. Any takeover regulatory regime should take into consideration the fact that takeovers often take place in the

54 Krishna (n 20).
55 Varian (n 44).
56 Supra Part 1 (reference is made to the example where a profit-maximizing firm finds it profitable to impose an externality on the environment).
57 Indeed, in the context of takeovers, a bidder imposes a positive externality on rival bidders where it is made to reveal information procured pursuant to costly value discovery of the target firm. Infra Part 3.
58 Krishna (n 20).
59 Krishna (n 20). See also Myerson, Roger B, and Mark A Satterthwaite, 'Efficient mechanisms for bilateral trading' (1983) 29(2) Journal of Economic Theory 265–281.
60 Cramton and Schwartz (n 51).

context of considerable *layers* of information asymmetry, and frequently require costly investments in value discovery. Thus, to the extent that the objective of revenue maximization conflicts with welfare maximization, we argue that the latter should always prevail over the former.

III. The Context In Which The "Ordinary" M&A Transaction Takes Place

According to Easterbrook and Fischel,[61] takeovers are an important means of reducing agency costs between shareholders and managers, as managers who fail to effectively maximize the value of the firm in accordance with their shareholders' interests would simply be replaced through the market for corporate control.[62] Furthermore, even if existing managers are acting in the best interests of their shareholders; it would be allocatively efficient to re-allocate ownership of the firm to a new owner who would be able to exploit synergistic gains from the takeover. For example, a manufacturer of mobile devices could enjoy economies of scope[63] if it were to acquire a manufacturer of wireless chips. The combined entity could gain productive efficiencies through exploiting the complementary resources of both firms. Thus, the extent to which efficient takeovers are *facilitated* by takeover regulation is a matter of paramount importance.

We begin our analysis by examining the *environment* in which takeovers take place. For completeness, we consider not only "hostile takeovers" where the target company's management does not (at least in the first instance) wish for the deal to go through, but also "voluntary transactions" where the target company agrees to sell the target company to the acquirer. Collectively, we term both "M&A transactions".

A. Costly Value-Discovery

The characteristic feature of almost all M&A transactions is *costly* value-discovery.[64] *Ex ante*, a potential acquirer does not know the exact value of how much the target firm is worth to him, as deals usually take place in conditions of information asymmetry. The target firm has superior information over its own affairs. Furthermore, the potential acquirer cannot obtain additional information to improve his estimate of how much the target company is worth to him without this expenditure of costs on value-discovery, since the target is unlikely

[61] Easterbrook, Frank H, and Daniel R Fischel, 'Corporate control transactions' (1981) 91 Yale Law Journal 698.
[62] Kraakman et al (n 9).
[63] Panzar, John C, and Robert D Willig 'Economies of Scope' (1981) 71(2) The American Economic Review 268–272.
[64] Cramton and Schwartz (n 51). See also Che and Lewis (n 26).

to voluntarily disclose all payoff-relevant information to him.[65] Even where target companies are obliged to disclose *some* information to public investors through securities regulations,[66] they are strongly disincentivized from revealing commercially sensitive information to potential acquirers in light of "free-riding"[67] and antitrust concerns.[68]

The phenomenon of costly value-discovery has critical implications for the optimality of candidate mechanisms used for the sale of corporations. In the conventional simultaneous ascending auction, bidders progressively raise their bids until a single winner remains.[69] This mechanism has often been lauded for its revenue and efficiency properties. However, as Cramton and Schwartz rightly point out, since bidding in M&A auctions is costly, actual M&A auctions differ materially from such auctions.[70] The key as to why such auctions may be inefficient lies in the fact that auction *participation* is endogenous to the bidder[71] – if a given bidder knows that the expected gains from ex post competition in a M&A auction will not exceed his expected outlays in value-discovery, he will simply not participate in the said M&A auction in the first place.[72]

[65] If trade were to take place in an environment of complete information, no mechanism for allocating the object would be required, as the target would simply 'choose' the acquirer with the highest valuation. See Krishna (n 20).

[66] Previously it was company law; the UK Companies Act, 1948 imposed disclosure requirements that were said to have 'resulted in far more takeovers of public companies': A Fallis, *Evolution of British business forms: a historical perspective* (ICAEW, London 2017) 21 also noting that 'since the Financial Services Act of 1986, disclosure requirements have also fallen within the purview of capital markets regulation'.

[67] See Easterbrook, Frank H, and Daniel R Fischel, *The economic structure of corporate law* (Harvard University Press, Boston 1996).

[68] See Teece, David J, 'Information sharing, innovation, and antitrust' (1993) 62 Antitrust Law Journal 465.

[69] Also known as an 'English auction', where the winning bidder pays the value of the second highest bid. See Krishna (n 20).

[70] Cramton and Schwartz (n 51).

[71] In this paper, we use the term 'bidder' as a synonym for the term 'potential acquirer'. The term 'bidder' is used as auctions are frequently invoked in many explanations of how a given mechanism works.

[72] Kahan and Klausner (n 24). A large volume of literature in auction theory has also focused on endogenous bidder entry/participation. Importantly, several authors have established that variations in the auction environment may affect optimal policies (like reservation prices) in ways not anticipated by models that ignore entry. For example, McAfee and McMillan demonstrate that where bidders can enter upon paying a fixed entry cost, the seller should not impose a reserve price higher than his own valuation, unlike the case with a fixed number of bidders. Levin and Smith show that when entry is stochastic, reservation prices discourage entry–a desirable phenomenon in 'common-value' auctions but an undesirable one in 'independent-private-value' auctions. The final point is particularly relevant, as both screening and variations in valuation distribution are important characteristics in M&A transactions. See McAfee, R Preston, and John McMillan, 'Auctions with entry' (1987) 23(4) Economics Letters 343—347 and Levin, Dan, and James L Smith, 'Equilibrium in auctions with entry' [1994] The American Economic Review 585—599.

Inefficiency from costly value-discovery does not only arise from the preclusion of ex ante bidder participation. It also arises from a more serious problem – subsequent free riding on informational externalities associated with the first bidder's investments in value-discovery.[73] Consider the situation where an initial bidder invests costs in preparing and initiating a takeover bid. If bidder participation is sequential, a second bidder can simply free-ride on the first bidder's investments by issuing a "topping" bid which the target may wish to consider.[74] Since investments in value-discovery are sunk, the first bidder may be under-rewarded for his investment. Knowing this, the first bidder may be incentivized to not invest in the first place. To ameliorate such "free-riding" concerns, several commentators have suggested deal protection measures to protect ex ante investments in value-discovery.[75] We will discuss these measures later.

B. Valuation And Informational Structure

As discussed above, potential acquirers of a given firm may have *different* valuations of the *same* firm. For example, where acquirers are able to extract synergistic gains from the acquisition, they are likely to have idiosyncratic valuations of the target firm. Where valuations are distributed pursuant to such an "independent-private-values" framework, the *ex ante* valuation of any given bidder in an auction does not depend on his/her rival bidder.[76] Thus, a takeover resembles an independent private-values auction when the "social surplus that would be produced varies substantially across potential bidders".

In contrast, potential acquirers of a given firm may have *identical* valuations of the *same* firm. As an example, acquirers are likely to share the same valuation of a given target firm where the said firm's valuation is largely derived from liquid assets that have a stable market value. Where valuations are distributed in accordance with such a "common-values" framework, the *ex ante* valuation of any given bidder is perfectly correlated with his/her rival bidder.[77] Where valuations are imperfectly correlated with each other, the valuations are said to be distributed in accordance with an "affiliated-values" framework.[78] Here, potential acquirers of a given firm have different, but similar valuations of the *same* firm. This represents an intermediate position between the "independent-private-values" and "common values" frameworks.

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[73] Che and Lewis (n 26).
[74] Che and Lewis (n 26).
[75] Che and Lewis (n 26). See also Fraidin, Stephen, and Jon D Hanson, 'Toward unlocking lockups' (1993) 103 Yale Law Journal 1739–1834.
[76] Krishna (n 20).
[77] Krishna (n 20).
[78] Krishna (n 20).

Although valuation structure is exogenously determined by the preferences of potential acquirers, it is critically important to the determination of the optimal mechanism at hand. Why is this so? Under a "common-values" framework, bidder participation is generally inefficient. Because every bidder has the same underlying valuation for a given target company, restricting entry reduces aggregate transaction costs.[79] Of course, if managers were to restrict entry without inducing higher bids in return, revenue from sale of the target would be reduced accordingly.[80] On the other hand, under an "independent-private-values" framework, auctions tend to be desirable – competition between bidders is desirable as it leads to allocative efficiency.[81] As we will discuss later, the empirical incidence of how valuations are distributed in the M&A setting will be of critical importance in determining the optimal mechanism for the sale of corporations.

A recent wave of related literature has also suggested that the *informational* environment is an important factor in determining whether a given mechanism is optimal or not. Bids may *reveal credible information* on the underlying bidder's private valuation (under an "independent-private-values" framework) or signal of the object's valuation (under a "common-values" framework). For example, in sequential mechanisms where bidders have common or affiliated values, an initial bid that is high enough will reveal the attractiveness of the deal to other bidders.[82] Knowing this, however, an initial bidder who knows that he is revealing such valuable information might choose to strategically respond to such "free riding" on the information externality by reducing his bid.[83] This, in turn, would change the seller's revenue from the sale. In response, the seller might wish to correct these incentive problems by increasing the probability that the object is sold to the initial bidder. Addressing these strategic incentives is an important area of takeover regulation which we will return to later. For now, this suggests the importance of context.

C. Strategic Or Opportunistic Responses

Mechanisms in M&A transactions may also take on a *sequential* nature, where either participation or bidding may take place sequentially rather than simultaneously.[84] Given the sequential nature of such transactions, potential acquirers are likely to behave *strategically* or opportunistically in response to

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[79] See Cramton and Schwartz (n 51). See also Harstad, Ronald M, 'Alternative common-value auction procedures: Revenue comparisons with free entry' (1990) 98(2) Journal of Political Economy 421–429.

[80] Cramton and Schwartz (n 51).

[81] Cramton and Schwartz (n 51).

[82] Wang, Zhe, 'Structuring M&A Offers: Auctions, Negotiations and Go-Shop Provisions' (February 27, 2017), <https://ssrn.com/abstract=2925018> or <http://dx.doi.org/10.2139/ssrn.2925018>.

[83] ibid.

[84] Krishna (n 20).

the actions of the target management, the target shareholders, and other potential acquirers. The same reasoning would apply to all other players in any given transaction.

One example of such strategic behaviour in M&A transactions is the phenomena of *pre-emptive* bidding.[85] This is where the initial bidder may wish to pre-empt subsequent bidders by credibly signalling that he has a sufficiently high valuation through a high bid. In UK-style Takeover Codes, this is often reinforced by the insertion of a "no increase" statement in the offer document.[86] With this, selling shareholders often take such a (high) bid as it stands. As the bidder commits himself to not being able to improve on the bid, he is able to demonstrate his willingness to carry through with the deal. However, the first bidder generally possesses superior information about the value of the object, as he has invested in value-discovery. Thus, subsequent bidders might be deterred from placing a bid even if they have a potentially higher valuation than the first bidder.[87]

Second, the strategic incentives of potential acquirers are distorted by the presence of toeholds that they may hold in target firms.[88] To see how such a toehold may be distortionary, consider the incentives of a given bidder when he loses an auction. With a toehold, the losing bidder attains some "insurance" conditioning on losing, since he would gain some compensation from the winning bidder's premium over the current market price. In this way, the loser's bid effectively sets the price his rival pays when he loses. The higher his losing bid, the more profitable his expected payoff. Thus, a bidder with a toehold has an incentive to continue bidding to raise the winning price in case he loses the auction.[89] This occurred in Singapore in the takeover of Natsteel Ltd in 2002, where the successful bidder was forced by a virtual second bidder to continually raise its price until the Securities Industry Council (SIC) required the latter to "put up or shut up". This was a long, drawn-out process in which the increasing bids were slowly accepted by more shareholders (the first bidder eventually obtained 50.4%, largely because of changes to the Takeover Code a year earlier permitting toeholds up to 30% (from 25%), before a mandatory bid had to be made).

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[85] See Fishman, Michael J, 'A theory of preemptive takeover bidding' [1988] The Rand Journal of Economics 88—101. See also Aktas, Nihat, Eric De Bodt, and Richard Roll, 'Negotiations under the threat of an auction' (2010) 98(2) Journal of Financial Economics 241—255 and Dimopoulos, Theodosios, and Stefano Sacchetto, 'Preemptive bidding, target resistance, and takeover premiums' (2014) 114(3) Journal of Financial Economics 444–470.

[86] See eg Singapore Code on Take-overs and Mergers, r 20.2 ('Singapore Code'). There can also be a 'no extension' statement issued under rule 22.7 of the Singapore Code.

[87] However, the loss of the social surplus from inefficient allocation of the target firm may be compensated by the entry costs saved by the second firm. Fishman (n 85).

[88] Bulow, Jeremy, Ming Huang, and Paul Klemperer, 'Toeholds and Takeovers' (1999) 107(3) Journal of Political Economy 427–454.

[89] Che and Lewis (n 26).

Third, in M&A transactions, target shareholders do not act as a collective whole when dealing with potential acquirers. Rather, the board of a target company has considerable say in whether any proposed deal goes through or not. This is especially true in Delaware,[90] but is less often the case in UK-style Takeover Codes. In UK-style codes, mandatory takeover rules require a general offer for all the remaining shares in the company at the highest price paid in the past 6 months[91] when a threshold is reached (often 30% although in India it is 25%).[92] In contrast, inefficient takeovers often result from the U.S. target company board's ability to issue a "poison pill", also known as a "shareholders' rights plan" that makes it difficult for a bidder to make an offer to present shareholders directly.[93] A poison pill makes acquisitions unprofitable by diluting the potential acquirer's shareholding upon acquisition beyond a certain threshold – all bids are therefore made conditional on the target board redeeming its pill. This provides the board with a limited ability to set a reserve price in any given mechanism, as it can "just say no" in response to most proposed acquisitions.[94]

While the ability to set a reserve price may aid in maximizing the shareholders' payoffs, it is well established that reserve prices are welfare-distortionary.[95] The seller finds it optimal to reduce the probability of a sale occurring in exchange for a higher price. However, it would be socially optimal to maximize the probability of sale so long as the buyer's valuation is higher than that of the seller.[96] Thus, reserve prices are inefficient - in all probability, the seller may refuse to sell the firm even if there is a buyer who values it more than he does.

Finally, *unfaithful* management is a distinct possibility in most M&A transactions.[97] In particular, the incentives of management may diverge significantly from those of shareholders. Management will, in any given instance, maximize their own self-interest over that of their shareholders.[98] With unfaithful management, the choice of mechanism becomes important in so far it may force management to abide by certain "rules" that attenuate the possibility of management extracting surplus from the deal (or lack of a deal). For example, most auctions

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[90] See generally Block, Dennis J, Jonathan M Hoff, and H Esther Cochran, 'Defensive Measures in Anticipation of and in Response to Unsolicited Takeover Proposals' (1996) 51 University of Miami Law Review 623–662

[91] See the Indian Substantial Acquisition of Shares and Take-Over (SEBI) Regulations, 2011, where the 6 month rule is one method to determine the offer price.

[92] Schuster, Edmund Philipp, 'The Mandatory Bid Rule: Efficient, after All?' (2013) 76(3) Modern Law Review 529–563. The rule was introduced to the EU by the Takeover Directive (Directive 2004/25/EC).

[93] See also Dawson, Suzanne S, Robert J Pence and David S Stone, 'Poison pill defensive measures' [1987] The Business Lawyer 423–439.

[94] Cramton and Schwartz (n 51).

[95] Krishna (n 20).

[96] Krishna (n 20).

[97] Supra Part 2. See also Cramton and Schwartz (n 51).

[98] Jensen and Meckling (n 8).

reduce the possibility of profitable "side payments" made to management given the transparent framework in which auctions must take place.[99] However, it is important not to overstate the frequency of "unfaithful management", as boards face considerable extra-legal constraints on their behaviour over time.[100]

IV. Structuring The Optimal Mechanism For Takeover Regimes

Given the above analysis, it is clear that M&A transactions give rise to complex interactions that do not point in a common direction. Nevertheless, we attempt to provide some general guidelines on how such transactions should be structured with the optimal mechanism in mind. We attempt to trade-off the tensions between investment and allocative efficiency, while foreclosing opportunistic conduct by parties in M&A transactions.

A. Optimal Takeover Regulation: Competition, Deal Protection And Strategic Conduct

As mentioned above, auctions are mechanisms that have been lauded for their revenue-maximising and efficiency properties. In a rarefied setting, auctions allocate objects to bidders willing to pay the highest value for the object, and thus are allocatively efficient.[101] Yet, as we have seen from Part 3, the efficiency properties introduced by ex post competition have undesirable effects in precluding *ex ante* investments in value-discovery.

In 2011, the United Kingdom prohibited all deal protections (including termination fees) in M&A deals; ostensibly to protect the competitive process for potential bidders.[102] This may have been an over-reaction to the takeover of Cadbury by Krafts where the Panel thought that both the target board and

[99] See Jackson, Matthew O, and Simon, Wilkie, 'Endogenous games and mechanisms: Side payments among players' (2005) 72(2) The Review of Economic Studies 543–566. Under Commonwealth Takeover Codes, no special deals are allowed, see eg r 10 of the Singapore Code (this applies whether or not there is a competitive bid as the idea there is for the equality of treatment of selling shareholders). Bidders are to be provided equal access to information under r 9.

[100] It is important to remember that shareholders retain the power to remove directors with cause in the US and without elsewhere. Alongside with reputation concerns, there will be some convergence of management's interests with that of the shareholder's. See Kreps, David M, and Robert Wilson, "Reputation and imperfect information' (1982) 27(2) Journal of Economic Theory 253–279.

[101] Krishna (n 20). For example, in a second price auction, the highest-value bidder also pays the value of the second highest bidder in equilibrium, so it maximizes the seller's revenue in accordance with the 'information rent' that he pays for not knowing the bidders' valuations. This information rent is a premium paid by the seller to buyers/bidders for the information advantage that they have over their private valuations.

[102] On July 21, 2011, the Code Committee formally adopted the changes proposed in PCP 2011/1. These changes were published in a response statement, RS 2011/1 (Code Committee 2011b), and

shareholders may have focused too much on the offer price and not the long-term viability of the company. As Kershaw has pointed out, prohibiting deal protection was not in fact an immediate or obvious consequence of the Cadbury takeover.[103]

After the regulatory change, however, M&A deal volumes in the United Kingdom declined significantly, with no countervailing benefits to target shareholders in the form of higher deal premiums or more competing bids.[104] From an economic perspective, the protection of an initial bidder's investment may thus be a desirable feature that should be countenanced by the law. Such contractual devices are known as "deal protection" measures in M&A law – they attempt to facilitate *ex ante* bidder entry by compensating the initial bidder for his initial investment in value discovery.[105] At the same time, however, deal protection reduces the probability of winning for a non-recipient bidder, thus reducing competition for the target.[106] Nevertheless, Ayres has noted that the allocative efficiency of the sale is likely to remain the same in the presence of non-foreclosing bids.[107] The justification for this principle lies with the fact that break fees cause *all* bidders to bid below their valuations by the amount of the fee. This is because the net value of acquiring the target is reduced by the fee for both buyers – the non-recipient bidder loses the fee when he wins, but the recipient bidder also loses the fee if he wins. Indeed, much of the contemporary literature favours allowing the initial bidder deal protection; and substantial empirical evidence supports this position.[108]

It is for this reason that Singapore, whose Takeover Code is otherwise quite similar,[109] made an explicit decision not to prohibit deal protection devices such as the use of inducement or break fees outright. Singapore's experience with deal protection devices had been positive in both encouraging initial as well as rival bids while preserving shareholder value in a takeover. Instead, Singapore's Code requires that the break fees remain below a 1% threshold (as was the case in the

Instrument 2011/2 (Code Committee 2011c), and, as mentioned, entered into force on September 19, 2011. See now r 21.2 UK Takeover Code.

[103] Kershaw, David, *Principles of takeover regulation* (Oxford University Press 2016) 7.30.

[104] Restrepo, Fernán, and Guhan Subramanian, 'The Effect of Prohibiting Deal Protection in Mergers and Acquisitions: Evidence from the United Kingdom' (2017) 60(1) The Journal of Law and Economics 75—113.

[105] Kahan and Klausner (n 24).

[106] Here, a winning bidder is still the bidder with the highest valuation. However, with deal protection measures in place, there is a positive probability that the object might not be sold at all. This is similar to the imposition of a bidding fee or a reserve price. See Krishna (n 20).

[107] Non-foreclosing bids are bids that do not terminate the takeover contest. See Ayres, I, 'Analyzing stock lock-ups: Do target treasury sales foreclose or facilitate takeover auctions' (1990) 90 Colum L Rev 682–718.

[108] See Officer, MS, 'Termination fees in mergers and acquisitions' (2003) 69(3) Journal of Financial Economics 431—467.

[109] See WY Wan, 'Legal Transplantation of UK Style Takeover Regulation in Singapore' in Umakanth Varottil and Wan Wai Yee eds, *Comparative Takeover Regulation* (Cambridge University Press 2017).

UK Takeover Code before its 2011 changes). The regulator, the SIC, must also be consulted on their use.[110] This suggests a degree of merit regulation in the takeover market. However, the context-specificity of how bids are structured and how boards react to them, as well as differing shareholder and director interests, suggest that any firm rule prohibiting or allowing deal protection devices may not work if the goal is to promote allocative efficiency. Instead, the system in most UK-style Takeover Codes (a form of "soft law") allows for a degree of flexibility, alongside close consultation with a regulator that is sensitive to the fast-changing needs of the market.[111] This has been the case since at least 1968, when "the court's role in the matter was then overtaken by the creation of a Takeover Panel and Code".[112]

Indeed, the jury is still out on whether break fees are unambiguously efficient, as much of this may be context specific, given that these fees are negotiated and settled upon in situations of uncertainty. For example, while a break fee may be needed in order to encourage a first bidder to do its due diligence and come up with an offer,[113] it may be socially desirable for a break fee to be only given to a subsequent bidder (and not the first bidder) instead.[114] These devices may be especially useful for encouraging subsequent bids where the first bidder has an incentive to engage in pre-emptive bidding, or where the first bidder has a pre-existing toehold in the target company.[115]

Take, for instance, the case where there is a non-recipient first bidder. Singapore's experience with the 2013 takeover of F&N Ltd, a large Singapore conglomerate,[116] was that a break fee was necessary to encourage the *second* bidder to enter the fray. The end result was greater value for shareholders when the first bidder raised its bid and eventually won. Subsequent amendments to the Code in 2016 made it clear that boards of target companies may, but are not obliged to, seek a competing offer. Accordingly, a target board offering a break fee to a

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[110] R 13 of the Singapore Code. The position in Hong Kong is similar under r 33 of their Takeover Code. See further, Wan Wai Yee and Umakanth Varottil (n 4) [8.102].

[111] See further Ellis Ferran, 'Corporate Law, Codes and Social Norms–Finding the Right Regulatory Combination and Institutional Structure' (2001) 1 Journal of Corporate Law Studies 381, 408–409.

[112] Paul Davies, *Introduction to Company Law* (3rd edn, Clarendon Press 2020) 111. He also points out at 113 how the EU Takeovers Directives 2004 has given a more formalized basis to the Panel and Code–see now section 955 of the UK Companies Act, 2006 which allows the Panel to apply to court for an order for Code compliance.

[113] See Kahan, Marcel, and Michael Klausner, 'Lockups and the market for corporate control' (1995) 48 Stan L Rev 1539.

[114] This would likely be precluded in the instance where the first bidder was already granted a break fee. See Coates IV, John C, 'M&A break fees: US litigation versus UK regulation' in *Regulation vs Litigation: Perspectives from Economics and Law* (University of Chicago Press 2010) 239–284.

[115] Supra Part 3.

[116] For details of the takeover, see SIC, Public Statement on Competitive Situation in relation to Fraser & Neave, Limited (15 January 2013) <https://www.mas.gov.sg/news/media-releases/2013/public-statement-on-competitive-situation-in-relation-to-fraser-and-neave-limited>

second bidder would not, *per se*, be seen as frustrating the first existing offer.[117] In the usual instance, the prohibition against frustrating offers guides a target board – it prohibits the target board from taking actions that frustrate an offer unless it has the shareholders' approval.[118] Clarifying that it does not apply where a target board searches for a competing bid shows that Singapore boards can now also put a company on the auction block. Corresponding changes to the Code in 2016 then provide that there will then be a formal action to resolve a competitive situation, where neither party has declared its final offer price in the later stages of the offer period.[119]

Che and Lewis[120] argue that differing forms of deal protection give rise to distinct efficiency and revenue outcomes. According to the authors, break fees and stock lockups are non-equivalent tools for revenue and efficiency. As explained above, break fees akin to liquidated compensation for search or discovery costs may induce the socially desirable level of takeovers.[121] However, stock lockups (where shares are issued by the target to a favoured bidder upon a failure to consummate the deal),[122] create either too little or too much competition, depending on whether they are granted to the first or second bidder. Unlike break fees, a stock lockup shifts gains from the non-recipient to the recipient of the lockup.[123] Where a non-recipient wins an auction with stock lockups, he pays disproportionately more when compared to the same under break fees. As any given bidder receives "insurance" in the form of an increased stock price conditioning on losing, he has an incentive to bid more aggressively, which in turn means that the cost of subsidizing socially desirable bidder entry is higher than optimal. Indeed, Che and Lewis note that private incentives diverge from the socially optimal

[117] See Kraakman et al (n 9), on the discussion re the 'no frustration rule' in the context of UK-takeover codes.

[118] Kraakman et al (n 9). Note that this is also the reason why poison pills are generally prohibited in Singapore unless shareholder approval is obtained. See also Wan Wai Yee and Umakanth Varottil (n 4) [8.102] where the authors point out that post-bid poison pills are prohibited by the Singapore Code and pre-bid ones are restricted by general company law and the listing rules in the case of companies listed on the Singapore Exchange.

[119] R 20.5. Indeed, this rule was in a sense only introduced after the SIC trial-ed the use of such a sequential auction in the F&N case when the Code did not provide for it at that time to obtain a clear and final outcome when the Board had decided to 'sell'. This closely followed the auction procedure set out by the UK Takeover Panel in the case of Cove Energy plc in 2012. See SIC, Consultation Paper on Revision to the Singapore Code on Take-Overs and Mergers (6 July 2015) para 16. See also UK Takeover Panel, Consultation Paper (PCP 2014/1) on Miscellaneous Amendments to the Takeover Code (16 July 2014).

[120] Che and Lewis (n 26).

[121] Ayres (n 107).

[122] *Howard Smith v Ampol Petroleum Ltd* [1974] AC 821 (Privy Council) was the seminal 'proper purpose' decision which held that it was improper for a target to place its shares with a favoured bidder.

[123] The 'recipient' of the lockup is the potential acquirer who benefits from the agreement where he fails to acquire the target. In such an event, the said acquirer receives compensation (whether through pecuniary means or stock) in accordance with the terms of the agreement, should it be upheld.

setting, with target shareholders preferring them over break fees as they induce greater bidding competition.[124]

Again, this suggests the need for a context specific approach to deal with protection devices – depending on the factual matrix, some devices are socially desirable, while others are not. Regulators in UK-style takeover regimes, as with the courts in the Delaware, should not be asked to decide hypothetical cases.[125] Without relevant facts, a trier of fact may find it impossible to formulate a sufficiently bright-line rule that would implement an efficient outcome in a given majority of cases. Indeed, it has been said that the strength of the common law system has always stemmed from its preference for pragmatism over dogmatism.[126] As the bifurcated corporate structure may be viewed from a variety of perspectives that often conflict with one another, dogmatic rules[127] usually provide a view of the company that is correct from certain perspectives, but not others. Consulting early with takeover regulators on the permissibility of deal protection devices saves the bidder and shareholders the cost of having the entire offer unravelled later by a court.

B. The Limits Of Takeover Regulation: Identifying Valuation Structure And Addressing Strategic Conduct

As mentioned in Part 3, valuation structure is critical in determining the optimal mechanism, as optimality under a "common-values" framework is completely different from that of an "independent-private-values" framework.[128] Under a "common-values" framework, the competitive process does little to ensure allocative efficiency, as all potential bidders ultimately have an identical underlying valuation for the target firm.[129] Under an "independent-private-values" framework, however, the opposite is true.[130]

Are we able to identify the valuation structure under a practicable rule that minimizes the sum of both the error and administrative costs of enforcing such a rule?[131] Some commentators have suggested that "common-value"structures are

[124] Che and Lewis (n 26).
[125] See further, Wan Wai Yee and Umakanth Varottil (n 5) [8.102] distinguishing break fees from poison pills.
[126] See Grey, Thomas C, 'Holmes and legal pragmatism' (1988) 41 Stan L Rev 787–870.
[127] Eg Revlon-type director duties. Infra Part 5.
[128] Supra Part 3.
[129] Supra Part 3.
[130] This follows from the fact that potential acquirers have different valuations for the same target firm. Thus, any competitive process would allocate the firm to the acquirer with the highest valuation. Supra Part 3.
[131] See Kaplow, Louis, and Steven Shavell, 'Accuracy in the Determination of Liability' (1994) 37(1) The Journal of Law and Economics 1–15 and Christiansen, Arndt, and Wolfgang Kerber,

associated with *financial* buyers, who attempt to improve a given target's value by improving the target's capital structure, correcting target mismanagement or by improving the target's internal corporate governance.[132] On other hand, "independent-private-value" structures are associated with "strategic" or "synergistic" buyers, who attempt to acquire targets to benefit from economies of scope or economies of scale. It is difficult to see how any rule making such a binary distinction would be tenable in practice. Putting the issue of affiliated-value acquirers aside, would a law-enforcement agency be capable of evaluating whether an acquisition was proposed for "strategic" or "financial" purposes? Any such rule would also distort the incentives of potential acquirers to frame their acquisitions as "financially-motivated".[133] The reality is that there are almost always going to be mixed motives here and the law will not be consistent in dealing with them, particularly from a causation viewpoint.[134] These problems highlight the limitations of takeover regulation – in the face of limited information over investor preferences, courts can only do so much.[135]

Beyond inducing or reducing ex post competition where desirable, the optimal M&A mechanism should also improve the informational environment in which takeovers take place. For example, it is well known that where bidder values are affiliated, sequential mechanisms are informationally more efficient as compared to their simultaneous counterparts as they improve the accuracy of bidders' signals regarding their valuations.[136] Intuitively, sequential mechanisms

'Competition policy with optimally differentiated rules instead of "per se rules vs rule of reason" ' (2006) 2(2) Journal of Competition Law and Economics 215–244.

[132] Gorbenko, Alexander S, and Andrey Malenko, 'Strategic and financial bidders in takeover auctions' (2014) 69(6) The Journal of Finance 2513–2555.

[133] More formally, under such a rule, a potential 'financial' acquirer would have an incentive to mimic a 'strategic' acquirer. See Makris, Miltiadis, and Luigi Siciliani, 'Optimal incentive schemes for altruistic providers' (2013) 15(5) Journal of Public Economic Theory 675–699.

[134] See Verstein, Andrew, 'The Failure of Mixed-Motives Jurisprudence' (2019) 86(3) The University of Chicago Law Review 725–796. With the business judgment rule in the US, which is perhaps closest to what is discussed here, the test is to determine what the primary motive is (at 1170). In the context of the proper purpose rule for takeovers in the UK, see *Eclairs Group Ltd v JKX Oil and Gas Plc* [2016] 3 All ER 641, noted Hans Tjio, 'The Proper Purpose Rule' 2016 Lloyd's Maritime and Commercial Law Quarterly 176–185 (support for the but-for over the predominant purpose test).

[135] Thus, we submit that regulators are better able to identify the nature of a particular valuation structure pursuant to an open-ended standard, in contrast to a rule of law established by precedent. Cf Gorbenko and Malenko (n 132). Gorbenko and Malenko suggest that in 'common-value' takeover auctions, the information revealed through a bidder's decision to approach the target has a large negative impact on his expected gains from the acquisition. This in turn disincentivizes the initiating bidder from approaching the target. In equilibrium, each bidder never approaches the target no matter how high his valuation is. In contrast, in 'independent-private-value' takeover auctions, notwithstanding the revelation of a bidder's valuation to his rival, the rival does not update his valuation of the target upon learning that the auction is bidder-initiated. Thus, in equilibrium bids may be initiated by both potential acquirers as well as the target.

[136] See Bulow, Jeremy, and Paul Klemperer, 'Auctions vs Negotiations' No 4608 (National Bureau of Economic Research 1994). See also Milgrom, Paul R, and Robert J Weber, 'A theory of auctions

provide valuable information on the attractiveness of the target, and on any underlying shared component of the target's valuation.[137] Ostensibly, this suggests that takeover regulation should encourage the public disclosure of bids.

Nevertheless, one must be careful with such blanket prescriptions, since informational externalities are omnipresent in sequential mechanisms. In light of our analysis adopted above, a takeover regime which mandates the public disclosure of bids will disincentivize investments in costly value discovery.[138] Similar reasoning applies to the regulation of "unfaithful" boards, where courts and regulators have to balance the tension between the benefits from deal protection, and the costs from managers acting strategically at the expense of shareholder value.[139] Again, we advocate a context-specific approach in addressing these trade-offs.

V. Revisiting Takeover Law: Facilitating The Optimal Mechanism

We are now ready to address the normative desirability of our candidate takeover regimes. We first begin by describing the salient features of existing takeover law in Delaware, the UK, and Singapore. We then assess the desirability of three features in light of our earlier discussion.

A. Existing Takeover Law

Under Delaware takeover law, there are two different standards for fiduciary obligations in the takeover context. *Unocal*[140] sets the fiduciary standard for defensive tactics, while *Revlon*[141] sets the standard for fiduciary obligations once management has decided to sell the company. In contrast, UK-style Takeover Codes do not separate the two situations – both are subsumed within a flexible proper purpose rule, which requires directors to act fairly and provide shareholders with sufficient information, time and advice in which to make their own decision about whether to accept a bid. Furthermore, target boards are now encouraged to shop for competitive bids. In Singapore, they are also allowed to use deal protection devices as a starting point. If there is no resolution towards the end of the offer period, a formal modified auction procedure is then mandated which attempts to accelerate what would have occurred in an extended competitive offer process. This process came about using heuristics and "trial and error" on the part of the market regulator in working through actual takeovers, as opposed to any form of *a priori* reasoning.

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and competitive bidding' [1982] Econometrica 1089–1122.

[137] ibid.

[138] Supra Part 3.

[139] Supra Parts 2 and 3.

[140] *Unocal Corpn v Mesa Petroleum Co* 493 A 2d 946 (1985).

[141] *Revlon* (n 3).

In *Unocal,*[142] an acquiring company (Mesa) attempted to conduct a two-step takeover of Unocal. The first step involved a partial bid for 37% of Unocal at $54 in cash per share. This would be enough to vest control of Unocal in Mesa. The second step involved a Section 251 merger, but the shareholders would only receive $54 in debt securities (subordinated Mesa debt). In response to the "coercive" nature of the two-step takeover, the Unocal board elected to adopt a selective self-tender, by offering to buy back its own shares from its shareholders at a premium of $72 in a debt security if Mesa succeeded in its bid. However, Mesa was not allowed to participate in this deal. Thus, if Mesa had continued pursuing its proposed transaction conditional on Unocal's offer being accepted, it would have suffered huge losses that would make the acquisition unprofitable.

The Delaware Supreme Court devised an "enhanced scrutiny" standard to evaluate the Unocal board's conduct, where a two-prong "reasonableness and proportionality" test was used to determine if the "Business Judgement Rule" applies. When evaluating the "reasonableness" of the defensive measure, the Court noted that a key concern was whether the directors were "acting solely or primarily out of a desire to perpetuate themselves in office". Upholding *Unocal*'s defensive tender offer and the exclusion of Mesa from it, the Court accepted *Unocal*'s characterization of Mesa's bid as a threat both because of the structure of the deal and the inadequacy of the price. In particular, the Court viewed the deal as "coercive" given the collective action problem[143] that each shareholder faced. Although all of the shareholders would be better off if no one tendered into the low-priced first step, each individual shareholder had an incentive to tender their shares, since they would be worse off if the deal went through and if they had not tendered in the first step.[144] Given the severity of this threat, the court also held that the selective self-tender offer met the proportionality test.

The Delaware Supreme Court's decision in *Unocal* has been judicially reinforced over the years. In *Unitrin*,[145] for example, the court held the evaluation of a defence under the *Unocal* standard[146] should be conducted pursuant to a "range of reasonableness". Thus, so long as a defence would not preclude[147] the bid's success, it would fall within the range of reasonableness and the court would not substitute its judgment for the board's.[148] UK-style takeover regimes, however, approach

[142] Unocal (n 140).

[143] In this setting collective action problem is also known as the 'prisoner's dilemma'. See Coffee Jr, John C, and William A Klein, 'Bondholder coercion: The problem of constrained choice in debt tender offers and recapitalizations' (1991) 58 U Chi L Rev 1207–1273.

[144] ibid.

[145] *Unitrin Inc v American General Corpn* 651 A 2d 1361 (1995).

[146] The court referred to the 'proportionality' limb here.

[147] By preclusion, the court defined it as being 'mathematically impossible or realistically unattainable'.

[148] See also See *Air Products & Chemicals Inc v Airgas Inc* 16 A 3d 48 (2011), upholding the proposition that the power to defeat an inadequate hostile tender offers ultimately lies with the board of

these problems from a completely different perspective. In contrast to the use of defensive measures enacted by a board, the regulatory regime tends to disallow two-tier coercive offers.[149] In addition, partial bids require regulatory approval even given that such bids must be structured in order for shareholders to offer their shares proportionately or pro rata in order to reduce coercion. Such partial bids may also be impermissible if a bidder were to only look to acquire between 30 and 50% of the target company shares, and in Singapore the SIC has no discretion in this instance.[150]

Coercive bids aside, under UK-style Takeover Codes, the philosophy is to leave the decision whether to accept or reject the offer to the shareholders themselves through the provision of adequate information and advice.[151] The rules providing that a takeover offer cannot be frustrated,[152] are intended to preserve the existing shareholders' *choice* of whether to sell to the bidder, rather than protecting the management. While the UK-style position is ostensibly superior in relation to its context-specificity, Schwarcz has attempted to defend the Delaware position by suggesting that Delaware's takeover cases are only quantitatively different in that the interests of *long term investors* can even more clearly be considered by directors.[153] We suggest that this is better explained by the fact that Delaware does not have mandatory takeover rules,[154] which are of themselves already protective of the company and its shareholders. In UK-style Takeover Codes, these are part of the amalgam of rules in offering shareholders equality of treatment.[155] Indeed, takeover defences like poison pills in the US, which are ostensibly for protecting long term investors from being coerced to sell out, may be abused by the board of directors of a target company (acting less for shareholders in trying to maintain their management positions).

It must be noted that the US position is inconsistent: outside of takeover situations, the concern is almost solely with shareholder value.[156] At the same time, however, there may be some convergence across the Atlantic. After

directors, and that so long as the board articulates a legally cognizable threat (like an allegedly inadequate price of an offer), defensive measures that fall within a range of reasonable responses proportionate to that threat would be upheld.

[149] Note 2 to r 10 Singapore Code (seen as a special deal for some selling shareholders).

[150] R 16.3 Singapore Code (SIC will normally consent to a partial offer for less than 30% and will normally not consent to a partial offer for more than 50%).

[151] General Principles 9 and 10 Singapore Code. Contrast this to Delaware's position where the board of directors can 'just say no' to any takeover offer. Cramton and Schwartz (n 51).

[152] General Principles 4 and 7, and r 5 Singapore Code.

[153] Steven Schwarcz, 'Temporal Perspectives: Resolving the Conflict Between Current and Futures Investors' (2005) 89 University of Minnesota Law Review 1044–1091 at 1060–1.

[154] Contrast r 14 Singapore Code. See also Schuster, Edmund Philipp, 'The Mandatory Bid Rule: Efficient, after All?' (n 92).

[155] See General Principle 8, and rr 10, 17, 18, 19, 20.4 and 21.1 Singapore Code.

[156] Davies, supra n 112 has pointed out that the US 'reliance on fiduciary duties gives courts considerable flexibility on this matter'.

the takeover of Cadbury Plc by Krafts Food Ltd, the UK amended its Code in 2011, as we have seen, to restrict deal protection devices in order to "strengthen the target in negotiating takeover bids (and presumably promote shareholder primacy)".[157] The bracketed point is important – Wan and Varottil note that "while company law allows the board to consider the interests of stakeholders that are not shareholders, such interests cannot override the shareholders' interests (whether short-term or long term) and there is no method of enforcing such consideration if the board fails to do so".[158] It may be that the duty is to act for the "reasonable shareholder",[159] rather than a conflicted one (or one holding out). Similarly, in the context of corporate restructuring, one requirement for the court to approve a scheme of arrangement (which can involve a takeover) is that the scheme must ultimately be one in which "a man of business" or an "intelligent and honest member of the class" acting in his interest would reasonably approve.[160]

In the Delaware case of *Revlon*,[161] an acquiring vehicle, Pantry Pride, attempted to make a takeover bid for *Revlon*. In response, the *Revlon* board adopted several defences. In addition to a shareholder rights plan, the *Revlon* board also adopted a stock repurchase plan that committed *Revlon* to repurchasing shares in exchange for subordinated debt from external creditors, with covenants restricting *Revlon*'s ability to sell its assets and take on new debt. In response to these defences, Pantry Pride raised its price, but *Revlon* continued to resist, changing its strategy to countenancing a management buyout instead. In approving the management buyout transaction, the board waived the poison pill and the debt limitation covenant, but the bidding managers conducting the buyout managed to secure a lock-up on assets (giving them the option to buy assets upon Pantry Pride's successful bid), along with a "no-shop" provision[162] and a termination fee. Pantry Pride sued, seeking to enjoin these defences. Turning the *Unocal* reasoning on its head, the Court held that when it became clear that a company was going to be sold, the duties of the directors' shift from *Unocal* duties to that of an auctioneer, with a duty to sell the company to the highest bidder. If an active auction were in progress, the directors would not be permitted to take any non-shareholder interests into account.

[157] Wan Wai Yee and Umakanth Varottil (n 4) [8.102].

[158] Wan Wai Yee and Umakanth Varottil (n 4) [8.101].

[159] *Citco Banking Corp NV v Pusser's Ltd* [2007] Bus LR 960 (shareholders' voting to alter articles of association affecting the constitutional balance in the company). For directors, see (n 138).

[160] *SK Engg & Construction Co Ltd v Conchubar Aromatics Ltd* [2017] 2 SLR 898 [101]. See in the UK, *National Bank Ltd, In re* [1966] 1 WLR 819, 829A-E, *Hellenic & General Trust Ltd, In re* [1976] 1 WLR 123.

[161] *Revlon* (n 3).

[162] A 'no-shop' clause is a clause found in an agreement between a target firm and a potential acquirer that bars the target firm from soliciting a purchase proposal from any other party. Wang (n 83).

More importantly, the *Revlon* court invalidated the asset lockup, along with the "no-shop" provision and termination fee. In line with the court's earlier reasoning, the "no-shop" was impermissible in this context because the board had already decided to sell the company, and therefore had a duty to attain the highest price that it could.[163] This should be contrasted with Singapore's F&N case, where shareholders benefited from a higher price without the need for poison pills,[164] the prohibition of deal protection measures, or Revlon-type duties. There, a break fee provided to a rival, put the company on the auction block. This was followed by a formal modified auction imposed by the SIC, which resulted in a higher price for target shareholders. The use of a market driven regulatory authority avoided "all or nothing" solutions that courts might be tempted towards. In Delaware, this "all or nothing" solution posits two polar extremes – director primacy in response to unsolicited bids, subject to a shareholder-leaning duty to obtain the best price where a decision is made to let the company be taken over.[165] This "schizophrenic" approach results in substantial over and under-inclusiveness in takeover regulation, causing social inefficiency.[166]

UK-style Takeover Codes avoid the need to talk about such duties in the Hohfeldian sense since "reasonable shareholders" are always the focus in all takeovers.[167] Here, the proper purpose rule imposes a measured duty on the target directors to exercise their powers fairly in relation to "reasonable shareholders". This entails supplying an average shareholder with adequate information and, where possible, a sufficiently good price. As we will see, the "proper purpose rule"[168] gives force to efficient incentives without the need for hard-edged rules.

163 We will discuss the normativity of some of these measures later.

164 Which, as mentioned above, may lead to the risk of abuse by the board of directors of a target company.

165 See Unocal, (n 140), *Revlon* (n 3). See also Armour, John, Jack B. Jacobs, and Curtis J. Milhaupt 'The evolution of hostile takeover regimes in developed and emerging markets: An analytical framework' (2011) 52 Harvard International LJ 219–286.

166 Infra Part 5.

167 Infra 170.

168 The proper purpose rule creates a different 'duty' that is increasingly seen by many commentators as one that is owed by directors to the shareholders, which has been suggested here is the reasonable shareholder (This may even balance the interests of present and future shareholders: Hans Tjio, 'The Rationalisation of Directors' Duties in Singapore' (2005) 17 Singapore Academy Law Journal 52–83). This is unlike the other directors' duties, such as that of care and skill, and the best interest duty, which under Commonwealth law is almost exclusively owed to the company (*Percival v Wright* [1902] 2 Ch 421.). But it has also been argued here that the proper purpose rule is one that is not often litigated in the courts, as it surfaces in areas like takeovers, which are best administered on a day to day basis by a market regulator providing guidance to the various actors in the market for corporate control. In the few cases that have come before the courts, however, individual shareholders have been able to bring actions against directors without the issue of whether they are in truth corporate wrongs and hence to be brought as derivative actions (See eg, *Eclairs Group Ltd v JKX Oil and Gas Plc* n 134.). However, these have invariably been in the form of injunctions or other ex ante actions to clarify the shareholders' position upfront rather than for damages after the event. This is consistent with the point here about greater efficiency in having the regulator facilitate takeovers using a rule that promotes 'welfarist' considerations.

B. Defensive Measures

An overview of existing takeover law raises an immediate question – can defensive measures as sanctioned by *Unocal/Unitrin* possibly be justified in line with optimal mechanism design? We argue that this is not possible. Consider a typical coercive bid led by a potential acquirer. Even if this exploits coordination problems between shareholders *inter se*, any offer made by the acquirer must be at least as attractive when compared to the current value of the shares in question. Thus, even if potential acquirers can profit from the eventual sale of their acquired shares, a coercive bid does not affect efficiency – it is merely a transfer from existing shareholders to the acquirer. Furthermore, coercive bids are likely to be less common in settings where there is competition for the target, as the surplus of the potential acquirer dissipates in accordance with strong competition.[169] Moreover, the argument that the board enjoys an informational advantage over the shareholders with regard to the company's "true" valuation is weak. As Gilson *et al* point out,[170] the informational advantage of managers is largely reduced by disclosure.[171] In any case, if the concern is truly with coercion, this can be addressed more directly with UK-style mandatory takeover rules.[172]

More importantly, defensive measures have often been justified by the board's limited ability to set a reserve price, which maximizes revenue for the shareholders. However, revenue maximization goals clearly conflict with welfare maximization goals here. As explained earlier in Parts 3 and 4, reserve prices are simply inefficient, as with positive probability, the target will refuse to sell itself even if there is a potential acquirer who values it more than its current market value.

C. Application Of Revlon-Type Duties

In recent years, Delaware courts have cut back on the scope and extent of "*Revlon* Duties". In *Paramount v Time,*[173] for example, Paramount sued Time to enjoin Time's board from enforcing several defensive tactics that would stop Paramount from usurping Warner as a competing bidder with a higher price. The Court noted that any application of *Revlon* should be restricted to when the board declares that the board is seeking to actively sell the company, or where the board abandons its "long term strategy" to seek a breakup of the company. As the Time

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[169] Ie Bertrand type competition. Supra 41.

[170] Enriques, Luca, Ronald J Gilson, and Alessio M Pacces, 'The case for an unbiased takeover law (with an application to the European Union)' (2014) 4 Harv Bus L Rev 85–128

[171] More importantly, while errors in shareholder valuations are largely 'cancelled out' by shareholder *heterogeneity*, the effects of managerial self-interest (reflected by 'unfaithful' boards) are not attenuated.

[172] Supra Part 5, s A.

[173] *Paramount Communications Inc v Time Inc* 571 A 2d 1140 (1989).

board's actions were merely a defensive response to a hostile takeover and not an abandonment of the company's continued existence,[174] the Time board was held not to be in breach of their *Revlon* duties.

In *Lyondell,*[175] the Lyondell board approved a merger with Basell for $8 a share, a price which their financial advisor determined was fair. However, the board did not conduct a market check, resulting in a shareholder suit alleging that the board had failed to take the necessary steps to ensure that the price was fair. The Supreme Court held that the mere fact that a company was "in play"[176] did not mean that the board was subject to *Revlon* duties. Rather, *Revlon* duties would only apply if the board expressly initiated the sale. Thus, the board could essentially adopt a "wait and see" approach in response to a bid so long as it did not declare that it was up for sale. Indeed, many of these outcomes turn on thin factual distinctions. Given the inherent uncertainty and arbitrariness involved in cases like *Lyondell*, it is easy to see how it may be preferable for Codes to create context-specific standards. In contrast, courts may have an advantage in applying stable rules, which simply are not workable in takeover situations. It has been said of the UK position that the Takeover Panel "keeps abreast on a near day to day basis with the progress of takeovers bids so as to be able to intervene and give directions to the parties in order to resolve problems as they arise, avoiding as far as possible after-the-event remedies when the optimal solution to the problem may no longer be available".[177]

Indeed, in line with academic commentary on the issue,[178] we could argue that *Lyondell* was wrongly decided from an efficiency point of view. To see why, consider the analysis of Gorbenko and Malenko,[179] who posit that bidders do not approach a target with prospective bids in a "common-value" setting, as they would not want rival bidders to "free-ride" on the information gleaned from their prospective bids. In equilibrium, they argue that we should only expect to see target boards or controlling shareholders initiating bids in such a setting. However, we also know that the efficiency effects following from the competitive process do not apply in the common-value setting – as every bidder has the same underlying valuation for the target company, restricting entry reduces aggregate transaction costs.[180] Indeed, to apply *Revlon*-type duties only where the board initiates the

[174] The court noted that Time was moving from a dispersed ownership structure to another dispersed ownership structure.

[175] *Lyondell Chemical Co v Ryan* 970 A 2d 235 (2009).

[176] ie that someone had made an offer for control or had filed a statutory notification showing that they intended to make an offer for control

[177] Davies, supra n 112 at 114 .

[178] Lederman, Lawrence 'Deconstructing Lyondell: Reconstructing Revlon' (2010) 55 NYL Sch L Rev 639.

[179] Gorbenko and Malenko (n 132).

[180] Supra Parts III and IV.

sale brings us *away* from the optimal mechanism – where we would expect to see *targets* soliciting bids, *Revlon*-type duties should not apply.

When should *Revlon*-type duties apply then? The efficiency properties of auctions clearly present themselves in settings of independent-private-value structures and unfaithful management.[181] Unfortunately, we do not have a dependable rule of identification regarding whether valuation structures correspond to an "independent-private-values" framework. More generally, we have seen various factual matrices where other mechanisms welfare-dominate auctions in accordance with empirical assumptions. Since ex post competition in M&A mechanisms is only beneficial to welfare in such a limited setting, the utility of *Revlon*-type duties is at best questionable.[182] The use of Hohfeldian relationships is not the optimal approach but perhaps forced upon courts with *Unocal's* otherwise free reign given to directors in responding to unsolicited bids. In contrast, the proper purpose rule applicable to target boards in UK-style Takeover Codes creates less of a duty than a review of the exercise of powers. In some sense, it is a middling position that is based on the old equitable doctrine of "fraud on a power".[183]

D. Deal Protection Measures

Our final point relates to a consistent theme raised in Parts 3 and 4 – the trade-off between ex post competition and the preclusion of deal-protection measures. In line with our earlier analysis, it is easy to observe that the holding in *Revlon* is perhaps too wide; with asset lockups and no-shop clauses entirely unenforceable. Furthermore, most cases have upheld termination fees only in the two to four percent range.[184] It is thus entirely plausible that such "maximum" fees are wholly inadequate in inducing the optimal level of bidder participation. However, we have seen that the Singapore Code now sets it at 1%. Prior to the 2007 amendments to the Code, a 3% threshold was permitted in the takeover of Natsteel Ltd as discussed above. As a conservative measure, any reform of *Revlon*-type duties should thus focus on whether the deal-protection measure at hand was introduced after bidder entry. If the measure was introduced prior to bidder entry, this would suggest that it was introduced to protect the bidder's incentives to invest in value-discovery. On the other hand, if the measure was introduced

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181 Cramton and Schwartz (n 51).

182 Our hypothesis is not that auctions are always inefficient, but rather the more subtle point that a takeover regime imposing auctions is more inefficient than a counterfactual without such a rule.

183 *Eclairs Group Ltd v JKX Oil and Gas Plc* (n 134) [15]. See also Briggs LJ in the Court of Appeal, [2014] 4 All ER 463 [92] who also said that 'I consider it important that the court should uphold the proper purpose principle in relation to the exercise of fiduciary powers by directors, all the more so where the power is capable of affecting, or interfering with, the constitutional balance between shareholders and directors, and between particular groups of shareholders' (at [122]). See now Sales, Philip, "Use of Powers for Proper Purposes" (2020) 136 LQR 384.

184 See Griffith, Sean J, 'Deal protection provisions in the last period of play' (2002) 71 Fordham L Rev 1899–1970.

subsequent to bidder entry, it would be plausible that the measure could have been implemented to foreclose competition.[185] Such measures should be rendered unenforceable by the Courts. Again, it may be that this does not sound like something courts, as opposed to a more sensitive and specialized market regulator, are well suited to handle.

In the Delaware case of *Paramount Communications v QVC*,[186] Paramount offered itself up for sale to Viacom. Pursuant to the deal agreed upon by the parties, Viacom was offered a no-shop provision (subject to a fiduciary out), a termination fee and a stock lockup. When QVC tried to enter as a competing bidder, Paramount considered QVC's offer, but did not attempt to change the deal protections granted to Viacom in its negotiations with the latter. The court held in QVC's favour, distinguishing the case from *Paramount v Time*. A change in control from a dispersed ownership structure to a controlling shareholder structure was seen as a condition that would invoke *Revlon*-type duties[187] as public shareholders would no longer be able to attain a controlling premium after the deal.

In invalidating the stock lockup and no-shop provisions, the Delaware courts held that the Paramount board had violated its *Revlon* duties by preventing the company from getting the highest price reasonably available. Was this justifiable in light of our analysis in Parts 3 and 4? As Che and Lewis have argued,[188] stock lockups induce either too little or too much competition because of the distortionary effects that they have on bidding, so the invalidation of stock lockups has some justifiable grounding.

The invalidation of the no-shop provisions preventing the solicitation of other offers, however, merits further discussion. With a no-shop provision, all informational externalities created by the initial bidder are completely internalized since there is no ex post competition. Thus, such a bidder would have efficient incentives to invest in ex-ante discovery of the target. In *Omnicare v NCS Healthcare,*[189] NCS was a financially distressed firm looking for a buyer to resolve some of its debt through a sale of its assets. NCS first approached Omnicare to see if it was interested in a sale, but the latter provided a low bid that was unacceptable to the shareholders and management of NCS. In the interim, NCS had solicited a bid from a competing bidder, Genesis, who offered a deal that paid off most of NCS's debt and also provided a small premium to NCS shareholders. As Genesis was afraid of being a "stalking horse" for Omnicare, it secured a quasi-exclusive agreement with NCS, which involved very strong deal protections.

[185] There were signs that it had become a "boilerplate term" in the UK which may explain why deal protection devices are now prohibited: Kershaw (n 103) 7.31.

[186] *Paramount Communications v QVC Network* 637 A 2d 34 (1994).

[187] Indeed, the court determined that the acquisition was equivalent to a 'sale'.

[188] Che and Lewis (n 23).

[189] *Omnicare Inc v NCS Healthcare Inc* 818 A 2d 914 (2003).

In particular, Genesis obtained a vote lockup from the majority shareholders committing to vote in favour of the deal, a tight "no-shop" clause with no "fiduciary out", and a one-day time period to accept the deal.

The Delaware Supreme Court invalidated the combination of the defensive devices, applying *Unocal* as the appropriate standard for evaluating deal protection devices. However, as the dissent rightly noted, the Court should have allowed the agreement to stand. Genesis would never have made its deal in the first place without these deal protection devices. Indeed, Genesis was well aware of the value that its bid would bring to Omnicare and wanted exclusivity to prevent that. Again, a similar scenario arose in the Singapore F&N case with respect to a break fee although we have seen that that does not have the anti- competitive effects of other deal protection devices. However, it does appear that having a market regulator assessing the financial and economic merits of a deal protection device ex ante; and perhaps then adjusting it seems a more workable solution if the goal is to promote efficient takeovers than having a court judge the competitiveness of such devices ex post. As we have seen, the UK now prohibits all deal protection devices as a starting point (though this was perhaps an overreaction to the Cadbury takeover).[190] But perhaps this is still less costly than "after-the-event remedies when the optimal solution to the problem may no longer be available".[191]

VI. Conclusion

In this short paper, we have attempted to identify the salient economic features of M&A transactions that are relevant to takeover regulation. While the attainment of the optimal mechanism in every instance may not be possible, we have suggested general guidelines as to how takeover regulation should move towards the optimal mechanisms that are applicable given real-world assumptions. With efficiency as the appropriate normative yardstick, we suggest the removal of defensive measures,[192] the removal of *Revlon-type* duties and the enforcement of ex-ante deal protection measures as simple reforms that would substantially improve a given takeover regime. This is the state of Singapore law presently, which arguably has merged the best of the US and UK laws (as suggested has been the case with her insolvency laws).[193] This requires recognition of

[190] Kershaw (n 103).

[191] Davies, supra n 112 at 114.

[192] Compare Kershaw (n 103) 338–369, describing how after the takeover of Cadbury by Krafts, the UK regulators were looking to make it harder for bidders to succeed there, and allow directors to take into account interests other than those of shareholders (or at least short-term shareholders who only want to know whether it is the right price to sell). They eventually introduced some rules prohibiting deal protection measures like inducement fees, but not other measures that more ostensibly prioritized the interest of long term shareholders over short term ones or which gave boards more power to defend against or frustrate takeovers (which he favours).

[193] Note by Senior Minister of State for Law and Finance, Indranee Rajah SC, on Debt Restructuring, Legal Industry Newsletters, 20 June 2017.

a proper purpose rule. Simply put, in cases where the exercise of a power would affect the strength and relative positions within the company of different sections or classes of shareholders, we should consider whether or not the power in the hands of directors was properly exercised in the light of the fairness, as between the different sections or classes of shareholders, of the purported exercise of the power. The focus is on the "reasonable shareholder". This balancing process is vital in takeovers where the use of soft law and the flexibility should be administered by a market regulator applying broad standards as opposed to going through the courts which are better at applying more specific rules.