

# **COMPARATIVE DIMENSIONS OF TAKEOVER REGULATION**

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Systems of corporate law and securities regulation differ considerably among jurisdictions. This Article focuses on differences among the rules that pertain to corporate takeovers. No jurisdiction's regulation of tender offers, however complex its terms, operates in a legal or economic vacuum. Thus, this Article begins by examining the institutional and economic factors that define the regulatory and transactional climate for tender offer regulation. These factors, in large part, explain why hostile takeover transactions occur in significant numbers in only relatively few countries. Section II surveys information describing the takeover environment in four of those countries—the United States, Great Britain, Canada and Australia. Section III considers the legal context in which takeover regulation is embedded in these countries and the restraints the legal system imposes on bidders and target management. The discussion then narrows to a comparison of the rules of these systems that pertain to specific issues in tender offer regulation. The Article concludes by considering the larger question of whether specific impacts on transactional activity can be traced to particular aspects of these regulatory systems.<sup>1</sup>

## **I. INSTITUTIONAL AND ECONOMIC FACTORS**

Comparative writing about legal rules carries risks, including the possibility of overemphasizing the differences among jurisdictions' formal legal rules at the expense of adequate attention to their similarities as well as inadequate attention to other less specifically "legal" aspects of the systems under comparison which may complement, if not always explain, some of the legal dissimilarities. The structure of the stock exchanges in each system and the regulatory function of these exchanges is of particular importance to understanding the institutional and economic

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\* Professor of Law, Duke University School of Law. I am grateful to Robert Austin, John C. Coffee, Jr. and Douglas Ginsburg for their comments on an earlier version of the manuscript. A slightly different version of this Article appears in *KNIGHTS, RAIDERS AND TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER* (J. Coffee, L. Lowenstein & S. Rose-Ackerman eds. 1987).

1. On each of these matters, in the interests of clarity, the Article first presents material for the United States, followed by Britain, Canada and Australia, almost always in that order.

context of corporate takeovers. Patterns of corporate ownership and control, in effect the demographics of shareholding, are of equal importance.

#### A. Stock Exchanges

In the United States, there are several stock exchanges and an organized system for over-the-counter trading in securities. All are regulated by the federal Securities and Exchange Commission. Among the exchanges, the New York Stock Exchange (NYSE) dominates with the largest number and highest market value of securities, listing about four times the number and about twenty times the market value of securities on the second leading exchange—the American Stock Exchange.<sup>2</sup> Stock exchanges in the United States operate autonomously, not jointly, and do not impose uniform standards for listing. Traditionally, the nation's largest companies have been listed on the NYSE. That fact, coupled with the NYSE's more exacting requirements for listing, has lent some cachet to an issuer's listing on that exchange.

The NYSE's listing requirements have often functioned as an important supplement to legally imposed requirements for corporate practice and operation. For example, the exchange has long required corporations to have audit and nominating committees composed of independent directors. Although practice recently has varied, by declining to list non-voting common shares (and voting shares of issuers with non-voting common shares) and common shares with differential voting rights, the NYSE has significantly inhibited the issuance of such securities by the most visible corporate constituency in the United States.

Britain, in contrast, has one stock exchange—the London Stock Exchange. Although under its guidance a limited over-the-counter market has developed in the last few years, most companies seek a listing on the Stock Exchange if they propose to issue shares to the public. The listing requirements for the Stock Exchange, interpreted and enforced by its Quotations Department, traditionally have demanded more disclosure by corporate issuers subject to them than do the Companies Acts.<sup>3</sup> Most

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2. 1980 SEC. ANN. REP. 128. In 1985, the American Stock Exchange listed 936 issues and the New York Stock Exchange listed 2,332. *See* Wall St. J., Jan. 2, 1986, at 9B, 16B. In dollar value of recent trading volume, the Pacific Stock Exchange outranks the American, however. *See* THE TORONTO STOCK EXCHANGE, 1985 FACT BOOK 53.

3. The problem of inconsistent but parallel disclosure requirements was resolved in part in 1985 when the Stock Exchange adopted directives implementing EEC Directives intended to harmo-

significant, however, is the London Stock Exchange's participation in the Panel on Take-Overs and Mergers, the self-regulatory body in Britain that administers and periodically revises the City Code on Take-overs and Mergers. The London Stock Exchange, the Bank of England, and other British financial institutions created the Panel in 1968 to deal with perceived abuses in corporate takeovers. Sanctions for violations of the Code are extra-legal and include, potentially, de-listing of securities by the London Stock Exchange and denial of the use of all British brokerage house facilities.

Canada, like the United States, has several stock exchanges.<sup>4</sup> Canadian stock exchanges are regulated by the provinces in which they are situated. The Canadian constitution, unlike that of the United States, does not confer on the national government plenary power to regulate interprovincial commerce. Thus, although Canada has a national corporations statute, securities regulation—and more specifically the regulation of stock exchanges—is a provincial matter. Further, the provinces have not enacted uniform legislation. Nonetheless, the Toronto Stock Exchange dominates the field in the number and perceived quality of securities listed,<sup>5</sup> an institutional fact that gives Ontario a bellwether position in securities regulation. Like exchanges in the United States, Canadian stock exchanges operate autonomously and have no common set of requirements for listing. In contrast to the United States, there is little over-the-counter trading in Canada.

In Australia, each of the six capital cities<sup>6</sup> has a stock exchange. All are members of the Australian Associated Stock Exchanges Ltd. (the AASE), as are some country Exchanges. At present, Melbourne and Sydney operate almost as one exchange, and all the exchanges' listing

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nize member states' law and practices for listing securities on stock exchanges. The effect of the regulations is to suspend the prospectus requirements of the Companies Act, 1985 for listed companies. *See* 1 A. BOYLE & R. SYKES, GORE-BROWNE ON COMPANIES § 10.1 (44th ed. 1986).

4. The Canadian exchanges are the Alberta Stock Exchange (in Calgary), the Montreal Exchange, the Toronto Stock Exchange, the Vancouver Stock Exchange, and the Winnipeg Stock Exchange. Toronto also has a separate futures exchange.

5. As of June 1985, the Toronto Stock Exchange accounted for 76.8% of the total dollar value of shares traded in Canada. Montreal is in a distant second place with 18.7%. *See* TSE FACT BOOK, *supra* note 2, at 52. By June 1985, 939 companies and 1,402 issues of securities were listed on the Toronto Stock Exchange, *id.* at 18, and 121 Canadian-based issues were listed both in Toronto and on an exchange in the United States, *id.* at 53.

6. The capital cities (and their states) are Melbourne (Victoria), Sydney (New South Wales), Brisbane (Queensland), Adelaide (South Australia), Perth (Western Australia) and Hobart (Tasmania). Sydney has a separate futures exchange.

agreements are virtually uniform.<sup>7</sup> The AASE, as noted below, has itself played a substantial regulatory role in connection with corporate takeovers. As in Canada, for constitutional reasons, aspects of corporate law and securities regulation are prerogatives of the six Australian states,<sup>8</sup> unlike Canada, Australia now has uniform companies and securities codes as a result of a compact among the states to follow the lead established by federal statutes in these areas. As in the United States, Australian administrative responsibility for the enforcement of securities legislation is lodged with a federal commission—the National Companies and Securities Commission (the NCSC). A separate body, the Ministerial Council, composed of the States' attorneys general has policy-making and general supervisory functions.<sup>9</sup> There is no developed over-the-counter market in Australia.

Even the simplest comparison of the institutions described above suggests that they differ significantly in their regulatory capacities. The Stock Exchange in London, alone and through the Panel on Take-Overs and Mergers, and the AASE in Australia have achieved uniform listing standards and other rules for the corporate issuers under their aegis. As described in detail below, they operate as significant regulatory forces in defining acceptable conduct in corporate takeovers. In contrast, stock exchanges in Canada and the United States do not speak with one voice. Although one exchange in each country is dominant, and imposes major constraints on its constituency of issuers through its listing requirements, these nations' exchanges, as groups, appear to play a less forceful regulatory role on issues relevant to takeovers than do the AASE and the London Stock Exchange. In addition, the vigor and depth of over-the-

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7. See R. BAXT, *AN INTRODUCTION TO COMPANY LAW* 328 (1982).

8. See generally Howard, *The Corporations Power in the Australian Constitution*, in THE CORPORATION AND AUSTRALIAN SOCIETY 12 (K. Lingren, H. Mason & B. Gordon eds. 1974).

9. The creation of a national body with substantial regulatory capacity over corporate matters was a political achievement requiring considerable finesse to negotiate and subtlety to execute. See Santow, *U.S. Participation in Australian Financial Services and Securities Markets*, in *LEGAL ASPECTS OF DOING BUSINESS WITH AUSTRALIA* 67-68 (E. Solomon, M. Brown & R. Chambers eds. 1984). Some of the Australian states' traditional mistrust of organs of national government was reduced by the compact structure, which permits any state to exit from the scheme by repealing its legislation to make the federal legislation applicable in that state. Further, all states have equal representation on the Ministerial Council, arguably reducing potential domination by the Commonwealth government. Finally, although the NCSC is situated in Melbourne, the Ministerial Council has its office in Sydney. The fact that neither is in Canberra, Australia's national capital, evidences the pervasive Australian concern with national influence. For a general discussion of Australia's distrust of Canberra and its basis in Australian history, see Albinski, *Australia and the United States*, *DAEDALUS* 395 (Winter 1985).

counter trading in the United States means that issuers who seek to raise public capital do not necessarily need to list their securities on an exchange.<sup>10</sup> This institutional fact also decreases the exchanges' regulatory potential in the United States.

### *B. Patterns of Corporate Ownership and Control*

The type of takeover bid that elicits the most popular and professional interest is, of course, the hostile offer, a bid unwelcomed by the target's management. In contrast, "friendly" bids can be seen as negotiated corporate acquisitions or amalgamations executed through the technique of an offer made directly to a corporation's shareholders. Whether hostile bids are feasible in any country is in large part a function of patterns of share ownership in that country, of shareholders' ability to transfer their shares freely, and of the voting rights allocated to publicly held shares.

In the United States, financial institutions hold a substantial percentage of the shares of the largest publicly traded companies.<sup>11</sup> Relatively few large, publicly traded companies, on the other hand, have one shareholder who owns more than fifty percent of the shares, which amounts to legal control. Even though more large companies have shareowners whose holdings are large enough to give them effective control, these amount to less than one-sixth of all large companies.<sup>12</sup> Thus, although

10. In 1984, NASDAQ share volume was two-thirds of the share volume of the NYSE and nearly 10 times the Amex volume. *NASDAQ 1984 FACT BOOK 11* (1985). NASDAQ's dollar volume in 1984 was \$153.5 billion; indeed, it is the third largest market in the world in terms of dollar value of trading. *Id.* at 106. Four thousand seven hundred twenty-three securities were entered in the NASDAQ system, *id.* at 10, which through computer technology enables national trading in the securities included. Although NASDAQ sets criteria for inclusion in its system, *see id.* at 16, its criteria concern such matters as the company's assets and public float and do not include the "regulatory" aspects of a listing agreement with a stock exchange.

11. By the end of 1980, major institutional investors accounted for 35.4% of all NYSE stock. *See NEW YORK STOCK EXCHANGE, 1983 FACT BOOK 52.*

12. The following breakdown was derived, as of February 1983, from the Standard & Poor's Index:

	<u>Number of Companies</u>	<u>Percentage of Companies</u>
Shareholder with legal control (50% or more)	6	1.2
Shareholder with effective control (20%-49.9%)	68	13.16
Widely held shares	<u>426</u>	<u>85.2</u>
Total	500	100%

*See REPORT OF THE SECURITIES INDUSTRY COMMITTEE ON TAKE-OVER BIDS, THE REGULATION OF TAKE-OVER BIDS IN CANADA: PREMIUM PRIVATE AGREEMENT TRANSACTIONS 75 n.89 (Nov. 1983) [hereinafter SECURITIES INDUSTRY COMMITTEE REPORT].*

ownership of large corporations may be significantly institutional, it is significantly diffuse as well. Further, the norm in public companies in the United States is free transferability of shares. This norm is reinforced by the NYSE's refusal to list shares that are not freely transferable. Only that Exchange and the Pacific Stock Exchange, however, decline to list shares with restricted or differential voting rights.

Patterns of shareownership in large Canadian companies are strikingly different. Unlike publicly traded companies in the United States, a majority of large, publicly traded Canadian corporations are legally or effectively controlled by an identifiable shareholder or group of shareholders.<sup>13</sup> In Canada, the aggregate concentration (i.e., percentage of economic activity accounted for by the largest firms) is currently higher than in the United States, although this concentration in Canada has decreased from levels earlier in this century.<sup>14</sup> Indeed, economic power in Canada appears to be concentrated in a few family-controlled groups. In 1985, for example, nine families were reported to control forty-six percent of the top 300 companies traded on the Toronto Stock Exchange.<sup>15</sup> This fact personalizes the concentration of corporate control in a striking fashion. In contrast with the NYSE, the Toronto Stock Exchange permits issuers to have common shares with restricted or differential voting rights;<sup>16</sup> the Toronto exchange also appears to list shares of companies with bylaws restricting the transfer of shares, beyond stated percentages, to non-residents of Canada.<sup>17</sup>

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13. *Id.* at 3. The following breakdown was derived from the companies with shares included in the Toronto Stock Exchange 300 Composite Index:

	<u>Number of Companies</u>	<u>Percentage of Companies</u>
Shareholder with legal control (50% or more)	137	48.4
Shareholder with effective control (20%-49.9%)	85	30.0
Widely held shares	61	21.6
Total	283	100%

*Id.* at 69 n.9.

14. See REPORT OF THE ROYAL COMMISSION ON CORPORATE CONCENTRATION 11-12 (1978) [hereinafter CANADIAN CONCENTRATION REPORT].

15. See *Taking Aim at Takeovers*, MacLean's, April 29, 1985, at 36.

16. See *The Toronto Exchange Policies, Policy Statement on Restricted Shares*, 4 CAN. SEC. L. REP. (CCH) ¶ 815-422 (1984). The Exchange recommends that a company with non-voting or restricted-voting common shares make provision for such shares to participate, on a "fair" basis, in any premium offered for the shares with superior rights. The inclusion of such protective provisions has become standard practice since 1981 in Canadian underwritings. See SECURITIES INDUSTRY COMMITTEE REPORT, *supra* note 12, at 32.

17. The TSE's listing requirements do not exclude the use of such qualifications for share own-

In Britain, financial institutions dominate as shareowners of publicly traded companies to an even greater extent than in the United States.<sup>18</sup> While the London Exchange will list non-voting shares, provided they are so designated,<sup>19</sup> fully paid-up shares must be freely transferable.<sup>20</sup> Finally, although the British economy seems more concentrated than that of the United States,<sup>21</sup> large British companies, unlike their Canadian counterparts, are not controlled by a small number of identifiable family groups.

Shareholdings in Australia are also dominated by institutions, especially life insurance companies. Of course, the dollar volume of trading on Australian exchanges is much smaller than that on exchanges in the United States. While the estimated volume for the NYSE might be \$3.5 billion in one typical day, the comparable volume on all exchanges in Australia would be \$40 million.<sup>22</sup>

Once again, however, one should not overemphasize the importance of the differences among these countries. They share one trait of supervening importance for the purpose of this Article: all have active markets in which hostile as well as negotiated corporate acquisitions occur frequently. The question that immediately comes to mind is why such transactions, particularly hostile transactions, do not occur with equivalent frequency in any number of other market-economy countries with active public trading in securities. The hostile corporate transaction is, indeed, virtually a non-event in many countries that otherwise are similar to those discussed in this Article. For example, countries on the European continent and Japan<sup>23</sup> appear to have few if any hostile corpo-

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ership, and their use in large Canadian companies has been reported. For example, in 1976 the Canadian company Brascan adopted, at its management's urging, a bylaw prohibiting foreign interests from owning more than 49% of Brascan's shares. The company's institutional investors believed the change lowered the price of their shares and perceived it as a management device to perpetuate its control. See Brown, *How Jake Moore Lost Brascan*, CAN. BUS. Nov. 1979, at 131.

18. In 1975, institutions owned 46.8% of all shares listed on the London Stock Exchange. See M. Blume, *The Financial Markets*, in BRITAIN'S ECONOMIC PERFORMANCE (1980). More recent estimates set the percentage at a higher point.

19. See THE STOCK EXCHANGE, ADMISSION OF SECURITIES TO LISTING, § 9, ch. 1, para. II.

20. See *id.*, at § 9, ch. 1, para. I.

21. See SECRETARY OF STATE FOR PRICES AND CONSUMER PROTECTION, A REVIEW OF MONOPOLIES AND MERGER POLICY: A CONSULTATIVE DOCUMENT 9 (1978).

22. See Santow, *supra* note 9, at 63. At present, about 32% of shares are held in the name of persons, whereas in the early 1950's 75% of shares were held by persons. *Id.* Trading volume on the Australian exchanges is less than comparable volumes on the Toronto and London and New York exchanges.

23. A rare exception was the \$1.4 billion bid made in 1985 by Trafalgar Holdings and a British

rate takeovers.

Explaining why events do not happen tends to be more interesting than explaining why events do happen, but it also tends to be more difficult, especially where, as with the non-occurrence of hostile takeovers in some countries, many different explanations are plausible. Nonetheless, it is useful to isolate two features of shareownership patterns that are essential to the development of an active market for corporate acquisitions, including hostile acquisitions: 1) shareholders' ability to transfer shares free of restraints within the unilateral control of the company's management, and 2) public ownership of shares holding voting rights sufficient to constitute legal control. In countries in which hostile acquisitions do not occur, one or both of these elements appears to be missing.

### *1. Share Transferability*

As noted above, stock exchange listing requirements in the United States and Great Britain preclude the use of restrictions on share transferability in publicly traded companies. Indeed, in both countries the restriction on share transfer is typically characterized as an earmark of a private company.<sup>24</sup> In other systems, however, restrictions on share transferability are not similarly confined by law or practice to closely held enterprises. Canadian corporation statutes, for example, permit public offerings of shares that restrict transfer to non-Canadian residents

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partner for Minebea, a manufacturing conglomerate in Japan. The bid, reportedly the first hostile offer for a Japanese firm made by foreign interests, ended in April 1986 when the offerors sold the shares they had acquired in Minebea. After the offer was announced, Minebea announced that it would merge with another Japanese company on terms that would give it control over 30 million shares of its own stock and would increase to 53% the shares in safe hands unlikely to tender. The offer for Minebea also met with opposition from Japan's Ministry of Finance and other agencies. See N.Y. Times, Apr. 12, 1986, at 19, col. 1.

24. Changes in the provisions of the English Companies Acts touching on these sorts of restrictions occurred as a result of the United Kingdom's adoption in 1980 of legislation to implement the Second Directive on Company Law adopted by the EEC's Council of Ministers in 1976. See European Report, Jan. 23, 1985, at 2. Under the 1980 legislation, consistent with the Second Directive, the "private company" became the residual form of corporate organization in Britain and the "public company" form became available only for those firms meeting the qualifications prescribed by the statute, including a fixed amount of minimum capital and a requirement that one quarter of the shares be paid up. Prior to the 1980 legislation, in Britain the public company was the residual form and the private company, like its American counterpart under some statutes—the "close corporation,"—was a classification applicable only to those corporations meeting specific tests set forth in the statute. In particular, § 28 of the Companies Act, 1948 required that the would-be private company's articles include some restriction on the transferability of its shares. The obligation to include restraints on share transfer to qualify as a "private company" was eliminated by the 1980 legislation.

when the company needs, for licensing purposes, to maintain a stated percentage of ownership by Canadians.<sup>25</sup> In some instances these statutes permit public offerings when the shares are subject to even broader transfer prohibitions.<sup>26</sup> Even though Canada obviously has an active corporate acquisitions market, because its economy historically has attracted substantial amounts of foreign capital investment,<sup>27</sup> imposing a Canadian residency requirement on some share transfers may in fact preclude some hostile takeovers that would otherwise occur.

Broad restrictions on share transferability are permitted by corporate statutes in continental Europe, even in publicly held companies. For example, in France the provisions of the *Code des Sociétés* concerning the *Société Anonyme*, the business corporation in France most similar to the American corporation, permit the corporation's articles to require that transfers to "a third party whomever he may be" be subject to the corporation's consent.<sup>28</sup> If the corporation does not consent to the transfer, it may, with the seller's consent, repurchase the shares itself or cause the shares to be purchased by a shareholder or a third party.<sup>29</sup> Even more draconian restraints on transfer are permissible under Swiss corporate law. Swiss law permits a corporation's articles to prohibit any transfer of

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25. See, e.g., *Ontario Business Corporations Act* § 42(2), Ont. Stat. (Ch. 4 1982).

26. See *Canada Business Corporations Act* § 168(1), III Can. Stat. (Ch. 115 1982) (permitting shares offered to public to be subject only to restraints against transfer to non-Canadian residents and to restraints necessary for company to qualify under Canadian law to engage in particular business activities).

27. See CANADIAN CONCENTRATION REPORT, *supra* note 14, at 4 (observing that Canadian industry has a higher proportion of foreign ownership than any other developed economy).

28. *Code des Sociétés* art. 274 (6th ed. Dalloz 1985). One question raised by the language quoted in text is whether such a provision in the company's articles applies to transfers among shareholders, so that the corporation's consent is required for such a transfer. In 1976 the Cour de cassation (France's highest court of ordinary jurisdiction) held that the reference to "a third party, whomever he may be" in article 274 did not include shareholders of the corporation, so that a shareholder would be free to transfer his shares to another without having the transfer subject to approval by the company. *Dessalien et Renard C. Soc. anon. Catel et Farcy*, 1977 DALLOZ SIREZ JURISPRUDENCE 455 (Cassation Commerciale 1977).

29. *Code des Soc.* art. 275 (6th ed. Dalloz 1985) *Dessalien et Renard* also laid to rest some doubts concerning article 275, which provides that if the corporation does not approve the proposed transferee of the shares, the directors or managers must, within three months after giving notice of their refusal of the transfer, cause the shares to be purchased either by a shareholder, or with the seller's consent, have them repurchased by the corporation as a reduction of its capital. The Cour de cassation held that article 275 did not oblige the shareholder to sell to the corporation nor did it give the corporation the right to dispossess the shareholder of his stock if he decides not to sell to the company. Thus, the court interpreted article 275 to mean that a shareholder may renounce his intention to sell if his proposed transaction is not approved by the corporation. See 1977 DALLOZ SIREZ, *supra* note 28, at 455-56.

registered shares.<sup>30</sup>

## 2. *Public Shares' Voting Rights*

Other prevalent characteristics of countries without active acquisition markets are widespread corporate cross-ownership of shares and restrictions on the voting rights of publicly held shares. Cross-ownership of shares occurs when a corporation places blocks of shares in friendly hands to guard against hostile bids. Even in countries with active acquisition markets, extensive cross-ownership tends to preclude hostile bids. Japan represents the leading example. In Japan, patterns of corporate cross-ownership of shares are common,<sup>31</sup> although centralized mechanisms controlling ownership and credit are much weaker than prior to World War II.<sup>32</sup>

Restrictions on the voting rights of publicly held shares also influence corporate acquisitions. A hostile bid will not be made for a company unless the shares available for sale (typically the public shares) can exercise sufficient voting rights to entitle a new owner to legal control or at least effective control over the corporation. Consequently, a hostile bid can be precluded if the voting rights of publicly held shares are restricted.

All systems of corporate law allow the issue of separate classes of stock that hold different voting rights.<sup>33</sup> On the European continent, however, corporation statutes authorize an additional technique for restricting the voting rights of publicly held shares, including common stock: the restriction of an owner's and his proxies' voting right to a stated number or percentage, independent of the number of shares owned. These restrictions originated in response to the common use of bearer shares (as opposed to registered shares). In a corporation with bearer shares,

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30. See *Doing Business in Europe*, COMMON MKT. REP. (CCH) ¶ 29,215 (summarizing Code of Obligations, Am. 621-22). No such restriction may be placed on bearer shares, however.

31. See T. ADAMS & N. KOBAYASHI, THE WORLD OF JAPANESE BUSINESS 53 (1969). Cross-ownership patterns persist despite the fact that the traditional holding companies and financial combines were broken up during the U.S. Occupation following World War II.

32. See B. RICHARDSON & T. UEDA, BUSINESS AND SOCIETY IN JAPAN 23 (1981). Nonetheless, Japanese equity markets continue to grow in attractiveness to foreign investors. Foreigners now own about six percent of shares listed in the Tokyo stock exchange, primarily through investment and pension funds, even though Japanese equities have an almost negligible dividend yield. See *Far Eastern Economic Review*, 1984 ASIA YEARBOOK 194.

33. An additional variation is created by corporate law in the Netherlands. There, the law authorizes the use of "priority shares" in all but the very largest public companies. Priority shares may give binding instructions to the shareholder meeting. See *Doing Business in Europe*, COMMON MKT. REP. (CCH) ¶ 26, 719 (summarizing Civil Code, Book 2).

management does not know the identity of shareowners unless the shareholders appear in person at the company's annual meeting.

The Belgian corporation statute imposes one of the most extreme percentage restrictions on the voting rights of shareholders. The Belgian corporation statute provides that no single shareholder (or proxy holders on his behalf) may cast more than one fifth of the total votes.<sup>34</sup> Belgian authorities view this restriction as an attempt to protect minority shareholders.<sup>35</sup> The operation of the restriction is partly analogous to mandatory cumulative voting rights in some American states. Mandatory cumulative voting, however, merely assures sizeable minorities of representation on the corporation's board of directors. In contrast, the Belgian rule means a majority stock owner will not be able to cast a majority of the votes. The majority owner's ability to exercise control thus depends on his ability to gain support from other shareholders. Such restrictions on voting rights are also permitted by German corporate law. In recent years, German corporations have used these restrictions to limit the voting power of petrodollar investors.<sup>36</sup>

The use of bearer shares can also lead to a predominance in corporate voting for the banks in which the shares are deposited for safekeeping. In Germany, although the "bankers' vote" has long been recognized as a significant factor in corporate control,<sup>37</sup> the interests of depository banks may diverge sufficiently to weaken the banks' collective influence on corporate management.<sup>38</sup>

In short, one limit on the occurrence of hostile bids is the unavailability of shares which, if purchased, will entitle their new owner to exercise voting control over the company. A closely related factor is the proportion of shares held by the public or by institutions likely to sell in response to an offer at an above-market price, in contrast to the proportion of shares held in "strong hands," that is by allies of incumbent management. The experience on the European continent with restrictions on the voting power of shares demonstrates that such restrictions can effectively preclude the appearance of hostile bids.

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34. See *id.* at §21,256 (summarizing Commercial Companies Code art. 76).

35. See *id.*

36. See *id.* at § 23,213. An appellate court in Germany in 1976 upheld a stockholders' resolution restricting voting rights.

37. See R. SCHLESINGER, COMPARATIVE LAW 776-77 (4th ed. 1980).

38. See Grossfeld & Ebke, *Controlling the Modern Corporation: A Comparative View of Corporate Power in the United States and Europe*, 26 AM. J. COMP. L. 397, 415 (1978).

## II. THE TAKEOVER ENVIRONMENT

The United States, Great Britain, Canada and Australia have each had a high level of corporate acquisition activity in recent years. After a brief discussion of activity in the United States, this portion of the Article presents available information concerning merger, acquisition and takeover transactions in the three countries.

In 1985, the United States set a record for merger and acquisition activity. The dollar amount of such transactions, estimated to be \$180-190 billion, topped the 1984 record of \$122.2 billion.<sup>39</sup> The number of large transactions distinguished 1985 from other years because 128 transactions in 1985 were valued at more than \$100 million apiece. Only eighty-seven transactions of such value occurred in 1984. Negotiated friendly acquisitions accounted for many of the 1985 mega-deals, although some of these transactions concluded a series of events that began with a hostile bid or a perceived threat of such a bid. Finally, in 1985, U.S. firms agreed to thirty deals worth at least \$1 billion, and four of those were structured as leveraged buyouts. In contrast, only twelve transactions valued at more than \$1 billion took place in the U.S. between 1969 and 1980.

Great Britain also had a high level of takeover activity in 1985. This level of activity exceeded that during the immediately preceding years. Between April 1970 and March 1985, 3,645 takeover bids—not all of which succeeded—were announced.<sup>40</sup> The Take-Over Panel described 442 bids as “failed.” The total number of announced takeover bids in 1984/1985 reached 202, and the Panel characterized twenty-five of those as “failed.” The “failure” category does not include bids that were not ultimately made, such as bids withdrawn prior to issuance of the offer document because a higher competing offer was announced. Over the fifteen-year period, 256 bids fell into that category, while ten bids were withdrawn in 1984/1985. Not all of the “failures” were bids resisted by the target company’s board. The overall “success” rate for bids in Britain between April 1970 and March 1985, excluding the failed bids and bids that otherwise did not go through, was eighty-one percent. Only thirty-one bids were partial bids, that is bids for less than any and all of the target’s share. Several of these partial bids resulted, or if successful

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39. See *Wall St. J.*, Jan. 2, 1986, at 6B, col. 1.

40. The term “announced take-over bid” includes schemes of arrangement to merge and offers to minority shareholders. Prior to 1981, the Code did not cover private companies.

would have resulted, in the offeror holding shares carrying less than thirty percent of the voting rights of the target.

Some rough contrasts can be drawn between the British and United States' failure and success rates over a portion of this period. A survey of 114 unsolicited tender offers in the United States from 1976-1980 established that twenty-eight percent of the targets remained independent. The offeror acquired only six percent of the targets at the price initially offered. In twenty-six percent of the transactions, the offeror acquired the target at a higher price. Thirty-nine percent of the targets were acquired by a white-knight—a party friendly to the target's management.<sup>41</sup> If one treats these white-knight acquisitions as "failures" from the perspective of the initial unsolicited offeror, then such bids had a "success rate" of thirty-three percent (if "success" includes paying more than the original price offered).

Canada has seen heightened takeover activity in recent years. The dollar value of mergers in Canada from 1975-1979, adjusted for the smaller size of the Canadian economy, was five times as large as the value of mergers in the United States. From 1980-1985, the value of Canadian mergers was two-and-a-half times as large as the comparable value for the United States.<sup>42</sup> Indeed, the volume of takeover activity has been high enough to reduce the "float" (that is, the shares not owned by controlling interests that are outstanding and available for trading) on the Toronto Stock Exchange.<sup>43</sup> The supply of public investment choices represented by the float has shrunk measurably over the last five years, even though some shareholders who receive a cash payment in a takeover transaction invest that cash in other equity securities, and even though

41. See Reich, *Takeovers: An Outline of Current Practice*, in CONFERENCE ON THE INTERNATIONALIZATION OF THE CAPITAL MARKETS (1981).

42. See N.Y. Times, Apr. 10, 1986, at 34, col. 1 (referring to study by William Stanbury at the University of British Columbia).

43. The statistics on net float loss on the TSE from 1978 to August 31, 1985 are:

Year	Float loss due to take-overs	New Issues (C\$ billion)	Float change
1981	6.568	1.500	-5.068
1980	1.575	3.185	+1.610
1979	2.147	1.105	-1.042
1978	2.256	.720	-1.536

Float is calculated on the market value of shares outstanding on the TSE 300 index after a deduction for shares owned by controlling interests. See Coleman, *Take-over Bids, Insider Bids and Going-Private Transactions—Recent Developments*, in SPECIAL LECTURES OF THE LAW SOCIETY OF UPPER CANADA: CORPORATE LAW IN THE 80s 155 (1982).

new public issues obviously add to the volume of shares available for public investment.

Both United States and Canadian transactions have been studied to determine the distribution of the gains between the acquiring (or bidding) firm and the acquired (or target) firm. The gains are represented as measured by the positive, abnormal stock returns resulting from the merger announcement. Studies of merger and acquisition transactions in the United States indicate that usually a takeover announcement is associated with large gains to shareholders of the target firm but only small and statistically insignificant abnormal returns to the bidder firm.<sup>44</sup> This discrepancy might be explained by competition among bidders which would drive the gains from the transactions to the target shareholders. Another plausible explanation, however, is the difference in size between the typical U.S. bidder and target. In addition, in the United States many bidders are "repeat players." Public knowledge that a company is a repeat player in takeover bids might cause that company's share price to reflect anticipated gains from its predictable level of future acquisition activity.

Evidence from studies of the Canadian market is strikingly different. In contrast to the United States, Canadian bidders and targets both appear to enjoy statistically significant abnormal returns after takeover and merger announcements.<sup>45</sup> Furthermore, Canadian bidders and targets tend to be of similar asset size, and weak antitrust enforcement leads to a large number of horizontal mergers. Finally, in the Canadian market, a substantial portion of merger activity is accounted for by the multiple acquisitions of a few relatively active acquirors.

In Australia, in recent years, many corporate takeovers have occurred. As in Canada, much of the takeover activity appears to be attributable to a small number of active acquirors. The Australian environment for such transactions has several characteristics that make it unique.

As compared with the United States, relatively fewer bids in Australia attract competing offers,<sup>46</sup> and a larger proportion of bids fail, even in the absence of competing bids. Further, many more bids in Australia are partial offers—currently forty percent of all bids by recent estimates<sup>47</sup>—

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44. See generally Eckbo, *Mergers and the Market for Corporate Control: The Canadian Evidence* 2 (Sept. 1985) (unpublished manuscript).

45. *Id.* at 9-10.

46. See Coffee, *Partial Justice: Balancing Fairness and Efficiency in the Context of Partial Takeover Offers*, 3 COMPANY & SEC. L.J. 216, 232 (1985).

47. See *id.* at 216.

while target shareholders, on average, appear to receive lower premiums than in the United States.<sup>48</sup> Finally, because until recently Australia did not tax capital gains transactions, this tax-related factor, not present in the three other countries, contributed to Australia's acquisition activity.<sup>49</sup>

### III. THE LEGAL CONTEXT

#### The legal regulation of corporate takeovers (apart from the antitrust

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48. A study of transactions in the United States, conducted by the SEC's Office of Chief Economist, examined successful tender offers in calendar years 1981-1983 and covered 91 any-or-all offers, 32 two-tier, and 25 partial tender offers. The study found that the average premium for any-or-all offers was 63.4%, that the average blended premium for two-tier offers was 55.1% and that the average premium for partial offers was 31.3%. The study also examined the outcome of multiple-bidder contests over the same period, in which at least one offer was a partial or a two-tier bid. There were 26 such contests over this period, involving a total of 62 bidders. *See Two-Tier Tender Offer Pricing and Non-tender Offer Purchase Programs, [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637 (June 21, 1984).*

The Australian study was conducted by Professor Peter Dodd for the Companies and Securities Law Review Committee and examined offers made for companies listed on the Sydney Stock Exchange from July 1981 through June 1983. During this period there were 118 "full" offers (those for 100%), 26 partial offers (those for less than 100%), and 15 competing bids. Twenty-eight bids were revised with new offer prices and closing dates. The mean premium for partial bids was 26.8% over this period. The study also computed investment returns available to target shareholders under the two strategies available to them after a bid is announced: strategy one—accept the offer, and strategy two—sell, either when the offer is announced or when it closes. Under strategy one, the highest return to target shareholders in full bids when the offerors accepted all tendered shares was 39.1; under strategy two, selling at the announcement produced a mean return of 20.4 while selling at the offer's close produced a mean return of 29.3. *See Companies and Securities Law Review Committee, Report to the Ministerial Council on Partial Takeover Bids (Aug. 1985) (Appendix).*

More recent information from Australia is that the proportion of partial to full bids has increased since 1983. *See* Coffee, *supra* note 46, at 216.

49. The Australian government imposed a capital gains tax (at ordinary income rates) on sales of assets acquired after September 19, 1985. Homes and some personal property are exempt, and cost bases are adjusted for the annual inflation rate. *See* Wall St. J., Oct. 16, 1985, at 1, col. 5.

Canada may also develop different taxation rules applicable to these transactions. Its national government has considered a proposal to make non-deductible interest paid on acquisition debt. *See Taking Aim at Takeovers*, Maclean's, April 29, 1985. Interest on acquisition debt (i.e., on funds borrowed to acquire shares in other companies) was not deductible in Canada prior to 1972. The then-Minister of Finance justified the shift to deductibility by arguing that, if interest on acquisition debt continued to be non-deductible, Canadian corporations would continue to be "at a disadvantage when competing in takeover bids with foreign corporations, which can deduct such interest in their home country." *See* Bale, *The Interest Deduction to Acquire Shares in Other Corporations: An Unfortunate Corporate Welfare Tax Subsidy*, 3 CANADIAN TAX'N 189, 198 (1981). As on a number of other regulatory issues, the Canadian choice seems consistent with a profound commitment to Canadian nationalism, to a "Canada owned by Canadians," even if a highly concentrated economy ultimately results. Or, in Professor Gordon Bale's trenchant observation, "[t]he fact that the whale is Canadian does not necessarily make it beneficial to be swallowed." *Id.* at 200.

dimensions, which are beyond the purview of this Article) is embedded in a context consisting of general corporation statutes, securities regulation and judicial interpretations of the fiduciary standards applicable to decisions of corporate directors and officers. Each of these interrelated bodies of law is important to a full understanding of the legal environment in which corporate takeovers occur. This section of the Article briefly surveys the relevant corporate law and securities regulation for each of the countries under discussion and discusses at length the differing treatments of corporate managers' fiduciary obligations.

As a general matter, in each system two types of legal rules are significant to the regulation of corporate takeovers: 1) rules that, by regulating the offeror and the terms of the offer itself, effectively raise the cost of the acquisition to the bidder or shift on to the bidder risks that would otherwise be borne by shareholders of the target company, and 2) rules that define the circumstances under which the target's management—or for that matter its shareholders—may engage in behavior or transactions designed to defeat a hostile takeover proposal.

#### A. The United States

In the United States, tender offers are regulated by the Williams Act,<sup>50</sup> enacted by Congress in 1968. The Williams Act grants the SEC authority to establish rules to govern tender offers for securities of companies registered under the Securities Exchange Act of 1934. The SEC as well as private litigants may bring actions for relief under the statute. Many states have also enacted statutes regulating tender offers, in some cases inconsistently with the Williams Act provisions. The constitutionality of state legislation in this area is frequently challenged under the supremacy and commerce clauses of the United States Constitution.<sup>51</sup>

Prior to the enactment of the Williams Act, tender offers inhabited the transactional equivalent of the Hobbesian state of nature: they were, at least to some observers, nasty, brutish and, in most cases, short as well because the offeror was free to structure the offer so that it was of brief

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50. The Williams Act added §§ 13(d), 13(e), 14(d), 14(e) and 14(f) to the Securities Exchange Act of 1934 (codified at 15 U.S.C. §§ 78l; 78m(d)-(e), 78n(d)(f) (1982)).

51. See, e.g., *CTS Corp. v. Dynamics Corp. of America*, 55 U.S.L. W. 4478 (U.S. Apr. 21, 1987) (Court holds Indiana Control Share Acquisition Act is not preempted by Williams Act and does not violate Commerce Clause); *Edgar v. MITE Corp.* 457 U.S. 624 (1981) (Court invalidated Illinois first generation tender offer statute under supremacy and commerce clause theories); Thompson, *Defining the Appropriate Realm of State and Federal Regulation of Tender Offers*, 64 WASH. U.L.Q. — (1986) (discusses fate of second and third generation tender offer statutes).

duration. Offerors could freely define the terms and conditions of their offers and bind offerees, once the offer was accepted, to an enforceable contract to sell the offeree's shares. Apart from the general anti-fraud and anti-manipulation provisions of the federal securities laws, the legal regime was one of *caveat vendor*. Offerees could thus be presented with a take-it-or-leave-it proposition with a short fuse. By reducing the possibility that any competing offer might emerge—or that the target's management might have time to persuade the shareholders that the company would be worth more than the offer price as an independent firm—such offers increased the risk that offeree-shareholders would sell for less than the company would bring in an open auction.

The Williams Act, like the other regulatory systems surveyed by this Article, altered this situation by prescribing mandatory or minimal terms for some elements of offers. For those matters so addressed by the statute, the offeror is no longer the full master of the offer's terms and structure. Offerors now must keep offers open for a specified minimum period.<sup>52</sup> If the offer is for fewer than all of the target's shares, it may not be made on a "first come, first served" basis. If an offer is oversubscribed, the offeror is required to accept shares on a prorated basis from those shareholders who have tendered.<sup>53</sup> Under the Williams Act, but not all other systems of takeover rules, shareholders have the right to withdraw shares tendered within specified time limits and the right to receive any increases in consideration under the offer.<sup>54</sup> The Act also requires offerors to disclose specified information either prior to or contemporaneous with the announcement of the offer, and the target corporation's management must circulate its views on the offer to its shareholders. Finally, the Williams Act requires that persons who acquire five percent or more of a company's equity securities disclose their interest within ten days after the acquisition.<sup>55</sup>

The federal regulation of tender offerors introduced by the Williams Act caused bidders to bear risks that otherwise could be allocated to target shareholders. Nonetheless, the assumption that the Williams Act inhibited the occurrence of hostile bids or, in the view of the President's Council of Economic Advisors, "likely caused a decrease in the number of takeovers and a decrease in the gains resulting from takeover activ-

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52. See 15 U.S.C. § 78n(d)(5).

53. See 15 U.S.C. § 78n(d)(6).

54. See 15 U.S.C. § 78n(d)(5), (d)(7).

55. See 15 U.S.C. § 78m(d).

ity”<sup>56</sup> is problematic. The drafters of the Williams Act stated that they desired its effect to be neutral as between offerors and target management.<sup>57</sup> Implicitly, a statutory posture of neutrality toward a type of transaction tends to legitimate it.

Further, Congressional enactment of the Williams Act jeopardized inhibitive state regulation of tender offers. This effect is significant because the states’ regulatory choices on these transactions tended to be more restrictive than the regulatory posture embodied in the Williams Act. To be sure, the Williams Act did not oust the states’ ability to regulate transactions in corporate control through provisions in state corporation statutes that define the attributes of shares or that regulate or prohibit various corporate transactions. In *CTS Corporation v. Dynamics Corporation of America*, the Court upheld the constitutionality of the Indiana Control Share Acquisition Act, which effectively conditions acquisition of control of a corporation on approval of a majority of the corporation’s preexisting disinterested shareholders. Unlike an Illinois statute earlier invalidated by the Court, the Indiana statute applies only to corporations incorporated in Indiana, imposes no indefinite delay on tender offers, and does not enable the state itself to determine the merits of the offer.<sup>58</sup> The

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56. See President’s Council of Economic Advisors, 1984 Report at S-40 (BNA Special Supplement).

57. See, e.g., S. REP. NO. 550, 90th Cong., 1st Sess. (1967).

58. 55 U.S.L.W. 4483 (U.S. Apr. 21, 1987). The Illinois statute was held unconstitutional in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982). A majority of the Court held that the statute impermissibly interfered with interstate commerce; a plurality also believed it to be preempted by the Williams Act.

One perplexing question left open by the Court’s analysis in *CTS Corp.* is the constitutional significance of the fact that the Indiana statute applies only to companies incorporated in that state. Many passages in the majority’s opinion emphasize that the law of a corporation’s state of incorporation has traditionally been thought to define its attributes and regulate its internal affairs. *See, e.g., id.* at 4483 (“[t]his beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of its state of incorporation.”) On the other hand, the Indiana statute itself additionally requires for applicability that the corporation have its principal place of business, or substantial assets in Indiana, plus ten percent of its shareholders resident in the state or more than ten percent of its shares owned by Indiana residents or ten thousand shareholders resident in Indiana. The Court’s opinion, after noting that Indiana would have no legitimate interest “in protecting nonresident shareholders of *nonresident corporations*,” observes that “[m]oreover, unlike the Illinois statute invalidated in *MITE*, the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana.” 55 U.S.L.W. at 4484 (emphasis in original). If shareholders’ state residency is constitutionally crucial, the practical appeal of Indiana-style statutes to popular states for incorporation—like Delaware—that have relatively few shareholders of any particular corporation resident in them may be limited.

Delaware’s advisory group for corporate law recently decided not to submit a proposal based on

outer limits of the states' regulatory capacity await further legislation and litigation. It is noteworthy that in neither of the other two federal systems discussed in this Article—Canada and Australia—has the content of takeover regulation been complicated by ongoing tensions stemming from federalism itself. Thus, unresolved quandries about the terms of coexistence between federal and state law are not inevitable consequences of a federalist division of legislative competence.

A further issue in the regulation of offerors is whether to restrict the offeror's discretion to condition its bid. The offeror's ability to condition its bid freely, that is to condition its obligation to take and pay for tendered shares on the occurrence or non-occurrence of any number of possible events, is important to defining the cost and risk the offeror bears in making the bid. Unlimited power to condition the bid is unlimited power to shift to the offeree risks that would otherwise be borne by the offeror. The Williams Act, however, does not restrict the offeror's ability to condition its bid. Offerors in the United States frequently include in the offer conditioning language addressing such matters as the availability of financing for the transaction and the absence of significant litigation challenging the transaction. Nor is there any requirement in the United

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the Indiana statute to the legislature. See *Delaware Fails to Adopt Law on Takeovers*, Wall St. J., June 16, 1987, at 2, col. 2. One feature of the Indiana statute that may limit its appeal to other jurisdictions is a provision entitling the acquiror of shares to require that the corporation's management call a special meeting within fifty days of the acquisition so the other shareholders can vote on whether to confer voting power on the shares of their new fellow shareholder. Ind. Code § 23-1-42-7 (Supp. 1986). As the triggering event is the filing of an "Acquiring Person Statement" describing a proposed acquisition, the putative acquiring person need not own the shares at the time of the filing. This enables any potential bidder to require a shareholder vote on any takeover proposal, by describing a plan to acquire sufficient shares to trigger the statutory provision. In contrast, under Delaware law a corporation's directors are not obliged to refer unsolicited takeover proposals to shareholders. Further, under the Delaware statute, only a corporation's directors have the right to call a special shareholders' meeting unless the corporation's certificate or bylaws authorize other persons to call the meeting. Del. Code, tit. 8, § 211(d) (1983). Thus, in the absence of a certificate or bylaw provision creating such a right, Delaware law does not entitle a corporation's present shareholders—or prospective control shareholder—to compel a special meeting to be held.

One might well wonder whether the provision in the Indiana statute entitling the prospective control shareholder to compel a special meeting is crucial to the statute's constitutionality. The Court's preemption analysis in *CTS Corp.* emphasizes that the Indiana statute "does not give either management or the offeror an advantage in communicating with the shareholders about the impending offer." 55 U.S.L.W. at 4482. The offeror's ability to compel the special meeting contributes greatly to the statute's appearance of even-handedness. The Court's opinion also characterizes the statute as a device for empowering shareholders as a collective body. But unless the acquiring person is able to compel a shareholder meeting to be called, it is much more difficult to view the statutory disenfranchisement of its shares as merely an incident of an even-handed empowerment of the corporation's other shareholders.

States that large share acquisitions be made through a general offer to all shareholders.<sup>59</sup> Offerors are, however, prohibited from making purchases other than through the tender offer itself once the offer has been announced.<sup>60</sup> In short, and in contrast with the other regulatory systems discussed below, offerors in the United States have considerable discretion in structuring acquisitions.

Counterpoised with the relative freedom of offerors in the United States is the freedom of target company management to discourage hostile offers generally and to frustrate particular unwelcome bids. These questions are not addressed by the federal statute and remain the province of state corporate law. Courts assess management's decisions in these respects against the fiduciary obligations of care and loyalty to the corporation. Although the officers and directors of target corporations are freer in the United States than in some other systems to engage in defensive tactics, that freedom is not unbounded, and the fiduciary norms are of real significance.

The central question in the American cases, explored most fully in Delaware and New York, is the extent to which a court will defer to the decision of the corporation's directors, by treating the decision as an exercise of the directors' discretionary business judgment, to defend the corporation against an actual or prospective offer by deploying defenses against a particular offer or constructing anti-takeover devices with more generalized effect. The line of significant Delaware authority begins in 1964 with *Cheff v. Mathes*. In *Cheff*, the corporation's directors caused the corporation to repurchase, at a premium over market price, the stock held by a shareholder who had demanded a seat on the board and criticized the corporation's method of product distribution.<sup>61</sup> The Delaware Supreme Court held that the directors' burden of justifying the repurchase could be satisfied by a showing of good faith and reasonable investigation. The court interpreted this standard to require the directors to show reasonable grounds for belief that the shareholder's continued stock ownership constituted "a danger to corporate policy and effectiveness." The *Cheff* court found that the directors made such a showing.<sup>62</sup>

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59. See *infra* note 182 and accompanying text.

60. 17 C.F.R. § 240.10b-13 (1986).

61. 41 Del. Ch. 494, 199 A.2d 548 (1964).

62. *Id.*; but see Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 230 A.2d 769 (1967), in which the chancery court held that no showing had been made that the plaintiff represented "a reasonable threat to the continued existence" of the corporation, whose directors had issued a large block of authorized shares to a third party to abort the plaintiff's tender offer for the corporation.

Some commentators have criticized the *Cheff* court for being unduly lenient and for permitting the use of corporate assets to preserve the incumbents' control, so long as the directors were able to demonstrate, in retrospect, the existence of a dispute with the challenger over some aspect of corporate policy.<sup>63</sup> Nonetheless, in the same era, the Delaware Supreme Court imposed limits on the tactics available to management resisting challenges to its control. In *Schnell v. Christ-Craft Industries, Inc.*, a majority of the court held that the corporation's directors had abused their amendment power over the corporation's bylaws by revising them to advance the date of the shareholders' meeting, thereby disrupting the dissidents' proxy fight.<sup>64</sup>

Federal courts have interpreted Delaware law to embody a "business judgment" standard that insulates the merits of directors' decisions from judicial scrutiny in the absence of fraud, bad faith, gross overreaching or abuse of discretion.<sup>65</sup> This federal statement of Delaware law may, nonetheless, be unduly broad in light of more recent Delaware cases. Although some recent cases have upheld directors' use of specific defensive tactics, not all have deferred to the directors' decisions. The more recent Delaware cases examine much more closely the fit between the alleged threat to the corporation and each defensive transaction authorized by the directors. In these cases, the Delaware courts do not treat the appropriateness or necessity of defensive transactions as falling within the unreviewable discretion of the directors.

In *Unocal Corp. v. Mesa Petroleum Co.*,<sup>66</sup> the Delaware Supreme Court held that the directors of a target corporation properly exercised sound business judgment in responding to a hostile two-tier tender offer with a self-tender by the target for its own shares. In *Unocal*, the court emphasized that the directors' actions cannot be motivated solely or primarily by a desire to retain office. Their actions must reflect "a good faith concern for the corporation and its stockholders," and, in all cir-

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63. See Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 674-75 (1984).

64. 285 A.2d 437 (Del. 1971). In *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 402 (Del. 1985), the Delaware Supreme Court upheld a bylaw amendment, adopted through the statutory shareholder consent procedure after an acquiring person obtained control of 51% of the corporation's voting stock, that required a unanimous vote of all directors to take action, and required the presence of all directors for a quorum at meetings.

65. See, e.g., *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S. 1092 (1981).

66. 493 A.2d 946 (Del. 1985).

cumstances, their actions must be free of any fraud or other misconduct.<sup>67</sup> Further, the directors' response must be "reasonable in relation to the threat posed;"<sup>68</sup> thus, the directors must analyze the nature of the offer and its effect on the corporate enterprise. On both of these questions, the initial burden of proof lies with the directors.

Later the same year, in *Moran v. Household International, Inc.*,<sup>69</sup> the court upheld a corporation's adoption of a "rights plan" in advance of any actual offer. The intricate plan entitled each shareholder to rights that were triggered by a tender offer for thirty percent of the company's stock or by an acquisition of twenty percent of its stock by any single entity or group.<sup>70</sup> If a merger or consolidation occurred after anyone acquired twenty percent of the company's stock, the other shareholders would be entitled to buy \$200 of the acquiror's common stock for \$100, unless the rights were redeemed by the issuer's directors. The court held that the business judgment rule, as construed in *Unocal*, applied to the board's adoption of a defensive mechanism designed to ward off future offers.<sup>71</sup> The directors sufficiently established that they had adopted the plan in response to the threat of two-tier offers, that they were not grossly negligent in adopting the plan, and that the plan was a reasonable defensive mechanism in light of the perceived threat. No allegation was made that the plan was adopted in bad faith or to entrench the directors in office. Finally, as in *Unocal*, the *Moran* court stressed the enhanced credibility of defensive measures adopted by directors who are independent outsiders.<sup>72</sup>

Nonetheless, to assess fully the significance of *Unocal* and *Moran*, one must take into account two other contemporaneous Delaware cases. In *Smith v. Van Gorkom*,<sup>73</sup> the court applied a gross negligence standard to decide whether directors had exercised an appropriate degree of care in making decisions related to significant corporate transactions. The court held the directors' behavior in *Smith* did not meet this standard because they assented to a merger proposal without the benefit of extensive deliberations or an expert's opinion on the company's value.<sup>74</sup> The directors

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67. *Id.* at 955.

68. *Id.*

69. 500 A.2d 1346, 1349 (Del. 1985).

70. *Id.* at 1349.

71. *Id.* at 1350, 1356.

72. *Moran*, 500 A.2d at 1356; *Unocal*, 493 A.2d at 955.

73. 488 A.2d 858 (Del. 1985).

74. *Id.* at 864.

reached their decision quickly and without inquiry into the basis for the merger price or the consequences and structure of the merger agreement. Finally, in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,<sup>75</sup> the Delaware Supreme Court invalidated a target's grant of an option on its most valuable assets, at a price unfavorable to the target, to a bidding group proposing a leveraged buyout. The bidding group included members of the target's senior management. The target granted the option to the management group during a bidding contest with a hostile offeror who had made a series of cash bids for any and all shares and had announced its determination to top any bid made by the management group.<sup>76</sup> The court held that the board's grant of the option demonstrated apparent self-interest because it was motivated, at least in part, by the directors' wish to alleviate the legal consequences of an earlier defensive transaction by retaining the involvement of the management-allied bidding group. In exchange for the option, the management group agreed to take steps that would protect the directors against liability arising from the earlier transaction.<sup>77</sup> The *Revlon* court did not find lock-up options inherently improper, but asserted that the business judgment rule does not protect their adoption when the sale and dispersal of the company's assets appear to be inevitable. Beyond that point, the directors' role is limited to the auctioneering function of obtaining the highest price for the corporation's assets.

Recent judicial interpretations of New York law have also imposed limits on the ability of directors to defend aggressively against hostile offers under the protective mantle of the business judgment rule. In *Norlin Corp. v. Rooney Pace, Inc.*,<sup>78</sup> the target's directors responded to large and unwelcome purchases of the corporation's stock by issuing common and voting preferred stock to a Panamanian subsidiary and a newly created employee stock ownership plan. The stock issued in response to the unwelcome purchases effectively assured the board of continued and irrefrangible voting control over the target. The United States Court of Appeals for the Second Circuit, applying New York law, held that the directors' desire to retain control, indeed to do so at all costs, appeared to

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75. 506 A.2d 173 (Del. 1986).

76. *Id.* at 178.

77. The target had previously offered to buy 10 million shares of its common stock in exchange for subordinated notes and preferred stock. The noteholders threatened to sue after the market price of the notes fell when the target announced its intention to accept the buyout proposal. *Id.* at 177.

78. 744 F.2d 255 (2d Cir. 1984).

be their sole justification for issuing the stock. Further, the court held that the defendants had not established that their actions were "legitimate" or "fair and reasonable."<sup>79</sup>

The same court invalidated the defensive use of a lockup option on substantial target assets in *Hanson Trust PLC v. ML SCM Acquisition, Inc.*<sup>80</sup> In *Hanson Trust*, as in *Revlon*, the directors granted the asset option to a bidding group proposing a leveraged buyout, including an equity stake in the enterprise for members of the target's senior management after the consummation of the buy out.<sup>81</sup> Further, the option price appeared quite favorable to the bidding group and unfavorable to the issuer. Although the directors' adoption of the option could not be characterized as grossly negligent, the *Hanson Trust* court held that the plaintiff had made a *prima facie* showing of a lack of due care and raised sufficient doubts concerning the directors' commitment to protecting shareholder interests. Consequently, the directors had the burden of justifying the option transaction and its terms. After the directors failed to meet this burden, the court granted the plaintiff a preliminary injunction against the exercise of the option.<sup>82</sup>

Thus, recent cases have interpreted Delaware and New York law to impose substantial limitations on the protection afforded by the business judgment rule to directors' adoption of defenses against hostile tender offers. Defensive transactions are most likely to be vulnerable in litigation if: 1) they are adopted in the midst of an active bidding contest; 2) the decision to adopt the defense does not appear duly deliberative and mindful of its consequences; 3) the effect of the defense is to terminate the bidding contest; and 4) the directors' decision has self-interested qualities. In contrast to the British and Australian precedents, however, even these recent American cases do not suggest that directors of a target improperly interfere with the constitutional prerogatives of shareholders in defending against hostile bids.<sup>83</sup>

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79. *Id.* at 265-66.

80. 781 F.2d 264 (2d Cir. 1986).

81. *Id.* at 267-72. In *Hanson Trust*, however, unlike *Revlon*, although the target's board knew some of its officers would obtain equity in the new company, their identities had not been disclosed at the time the target's directors had first approved the buyout agreement.

82. *Id.* at 274-77, 283.

83. One recent Delaware case suggests that the duty owed to stockholders may be different if the directors act to undo the consequences of a successfully completed takeover bid. In *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401 (Del. 1985), the target board issued a large block of stock to an Employee Stock Ownership Plan after the unwelcome acquiring party obtained 51% of its voting stock and submitted shareholder consents to amend the target's bylaws to protect its position. The

### B. Great Britain

Most regulation of takeovers in Britain is extra-legal. Although the Companies Act, by defining corporations' legal powers, limits the defensive transactions available to targets, the rules regulating bidders and targets in bids for public, and some private, companies are contained in the City Code, the product of the Panel on Take-Overs and Mergers. In some respects, the City Code's regulation of bidders is similar to that imposed by the Williams Act. The Code, like the Williams Act, requires extensive disclosure by bidders,<sup>84</sup> sets a minimum duration for offers,<sup>85</sup> and requires prorated acceptance for over-subscribed partial bids.<sup>86</sup> The Code also grants withdrawal rights to tendering shareholders, although these rights differ somewhat in technical respects from the withdrawal rights granted by the Williams Act.<sup>87</sup> The code, unlike the Williams Act, regulates conditions imposed on offers and disapproves of conditions "depending solely on subjective judgments by the directors of the offeror or the fulfillment of which is in their hands."<sup>88</sup> But offerors in Britain, unlike offerors in the United States, are permitted to purchase target shares outside the offer itself even after the offer has been announced.<sup>89</sup>

In its treatment of partial bids the Code differs more strikingly from the Williams Act. The Panel's consent is required for any partial offer. The Panel normally grants consent for those bids that will result in the offeror holding shares with less than thirty percent of the target's voting rights. The Panel will not grant consent, however, for any offer that would give the offeror more than thirty percent but less than one hun-

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court held the board's retrospective defense was not protected by the business judgment rule and constituted inequitable conduct.

84. See *PANEL ON TAKE-OVERS AND MERGERS, THE CITY CODE ON TAKE-OVERS AND MERGERS*, Rule 24 (1985) [hereinafter CITY CODE].

85. *Id.* Rule 31.1.

86. *Id.* Rule 36.7 ("Scaling Down").

87. Under Rule 34 of the City Code, target shareholders must have the right to withdraw shares after 21 days from the first closing date of the initial offer, if that offer has not by that date become or been declared unconditional as to offeree acceptances. Rule 10 requires, for any offer that if successful would result in the offeror holding more than 50% of the voting rights in the target, that the offer provide that it will not be declared unconditional unless the offeror has acquired or receives acceptances giving it over 50% of the voting rights. The net effect of this requirement is that target stockholders may tender, wait to see whether the bidder acquires the mandatory minimum, and then "detender" the shares and "retender" them to any subsequent bidder, if the bidder fails to achieve the mandatory minimum. *Id.* Rules 10, 34.

88. *Id.* Rule 13.

89. *Id.* Rule 27.1. The offeror is under a duty imposed by Rule 27.1 to include any material change in its shareholdings in its communications with offeree shareholders after the offer is made.

dred percent of the target's voting rights if the offeror or its associates have purchased shares in the target during the preceding twelve months.<sup>90</sup> Indeed, the Panel's consent is required to purchase any target shares during the twelve months *after* any partial bid; purchases during a partial bid are prohibited.<sup>91</sup> Finally, shareholders with a majority of the target's voting securities must approve separately any partial offer that could give the offeror more than thirty percent of the target's voting rights.<sup>92</sup>

The City Code makes partial bids less attractive as a means of acquiring effective control of a target. In particular, the requirement of a separate shareholder plebiscite significantly restricts the offeror's ability to acquire a substantial position by offering a relatively low premium because it permits shareholders to tender their shares while voting against the transaction itself. Thus, the separate voting requirement reduces the risk that a partial bid at a low premium will succeed simply because target shareholders will tender because they fear being left behind, with a new controlling stockholder, if their fellows tender.<sup>93</sup> The restrictions on share purchases before and after partial bids may also make the partial bid unattractive, while protecting shareholders against the risk that the offeror will acquire shares at prices higher than the partial bid price.

The City Code also imposes on offerors and other persons who acquire a sizeable number of shares an obligation to offer to buy out the target's remaining shareholders. This requirement has no counterpart in the Williams Act. Under the Code, any person who, together with those persons acting in concert with him, acquires thirty percent or more of the voting securities or rights of a target is obliged to make an offer to the target's remaining shareholders (whether their shares are voting or non-voting) at the highest price paid by the acquiring person or its associates for shares of that class within the preceding twelve months.<sup>94</sup> This buyout requirement is structured to apply to sizeable share acquisitions independent of the acquisition technique used, so that stock market transactions or privately negotiated acquisitions, as well as formal tender offers, all trigger the obligation.

The City Code's imposition of a buyout requirement accomplishes a

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90. *Id.* Rules 36.1 & 36.2.

91. *Id.* Rule 36.3.

92. *Id.* Rule 36.5.

93. See Gonski & Keenan, *Partial Takeovers*, 7 U. NEW S. WALES L.J. 217 (1984).

94. CITY CODE, *supra* note 84, Rule 9.

number of separate goals. First, it insures that all shareholders, non-controlling as well as controlling, will share equally in any premium paid by a buyer so long as at least thirty percent of the company's shares are sold. Second, it protects non-selling shareholders against the risk that the new controlling shareholder will exploit its position to their disadvantage.<sup>95</sup> Third, it eliminates the possibility that non-selling shareholders (especially those in the wake of a successful partial bid) will be bought out in a freezeout merger for a lesser consideration than that of the tender offer.

The position of target management also differs in Britain. The City Code requires that all offers be put in the first instance to the target's board or its advisors,<sup>96</sup> who must obtain "competent independent advice" on the offer and share the substance of that advice with their shareholders.<sup>97</sup> The Code also requires that any information given by a target to a preferred offeror be made equally available, on request, to other bona fide offerors or potential offerors.<sup>98</sup> Once an offer has been made or appears to be imminent, the Code requires that defensive transactions, which could frustrate the offer, be tested by a shareholder plebiscite. If the target board proposes to: 1) issue shares or options on shares; 2) create or issue securities convertible into shares; 3) sell or agree to sell any material amount of assets; or 4) enter into contracts "otherwise than in the ordinary course of business," the shareholders must vote in a general meeting to approve the transaction.<sup>99</sup> Shareholder approval is also required if the target attempts to redeem or purchase its own shares when an offer has been announced or appears imminent.<sup>100</sup> These rules do not, however, reach transactions that precede the time an offer is announced or reasonably appears to be in the offing.

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95. Shareholders in British companies who object to such treatment appear to be in a weaker position than their American counterparts to resolve their problem through litigation. For a full development of this comparison, see DeMott, *Current Issues in Tender Offer Regulation: Lessons from the British*, 58 N.Y.U.L. REV. 945, 992-94 (1983).

96. CITY CODE, *supra* note 84, Rule 1.

97. *Id.* Rule 3.1.

98. *Id.* Rule 19.4. The unwelcome offeror must, nonetheless, ask specific questions of the target company and cannot simply ask in general terms for all information provided to its competitors. *Id.*

99. *Id.* Rule 21. Shareholder approval is not required if the target board is acting to fulfill obligations under a prior contract.

100. *Id.* Rule 37.3(a). If the effect of a share repurchase or redemption is to give the directors and persons acting in concert with them 30% of the company's voting rights, they are obliged to make a follow-up bid to the remaining shareholders, subject to possible waiver by the Panel if an independent vote of stockholders occurs and procedures prescribed by the Panel for seeking the waiver are followed. See *id.* Rule 37.3 & Appendix A ("Whitewash Guidance Note").

Recently, target managements have mounted flamboyant advertising campaigns in the popular media to defend against hostile bids, but without uniform success. The Panel responded in 1986 by banning advertisements bearing on an offer or potential offer unless they are confined to "noncontroversial information" and they avoid "argument or invective."<sup>101</sup>

The Code's treatment of defensive transactions developed against a legal context that imposes substantial restrictions on the ability of the target's directors to use their powers to defeat hostile takeover bids. In the leading case, *Hogg v. Cramphorn Ltd.*,<sup>102</sup> after receiving an unsolicited bid for all of the company's common and preferred shares, the target's board responded by establishing a trust for the benefit of the company's employees, appointing themselves trustees of the trust, and issuing to the trust a large block of authorized but theretofore unissued preferred stock, which was assigned ten votes per share. The trust was designed to assure that over half of the votes were in friendly hands.<sup>103</sup> The court held that this use of the directors' power to allot shares was improper. Interestingly enough, the court faulted neither the directors' good faith nor their motivation to maintain a management structure they believed to be more advantageous to the company's shareholders, staff and company than that of the management likely to follow a successful takeover offer. Instead, in the court's view, the directors acted simply to retain their control and improperly interfered with the "constitutional rights" of a potential shareholder majority by preventing the bidder's offer from reaching the shareholders. *Hogg v. Cramphorn* reasoned that while directors may choose to pursue many courses, they nonetheless are under an obligation not to use their power to oppress shareholders.<sup>104</sup>

The significance of *Hogg v. Cramphorn, Ltd.* is not so much one of immediate and practical application in Britain (where the City Code now regulates defensive tactics in bids for most companies) but as a statement of principle to be followed, or at least distinguished, by Commonwealth courts outside Britain. In this respect, as noted below, the force of the principle appears to have been somewhat vitiated by later Commonwealth cases. In a subsequent case in Britain, *Cayne v. Global National*

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101. See *id.* Rule 19.2; *The Times* [London], Mar. 27, 1986, at 21, col. 2.

102. [1967] 1 Ch. 254 (1963).

103. *Id.* at 265-71.

104. *Id.*

*Resources P.L.C.*,<sup>105</sup> Vice Chancellor Megarry took the position that the principle of *Hogg v. Cramphorn* "must not be carried too far." Although in his view directors' actions are improper if they are motivated solely by a desire to retain or preserve "control as such," if other elements are present as well, the motivation of retaining control is not necessarily improper.<sup>106</sup> An example set in the opinion is a defensive allotment of shares by a target to defeat a business competitor's acquisition of shares in the target "with the object of running [the target] down so as to lessen its competition."<sup>107</sup> Thus, even under the British authorities, target directors may be able to justify defensive share allotments (and other transactions as well) on the basis of their full range of motivations as directors for seeking to retain control. Nevertheless, the extremity of the example used in *Cayne* leaves open the question of how concrete and palpable the projected injury to the target must be in order to support the directors' use of their powers to preserve their control.<sup>108</sup>

The position of directors in British companies is also, of course, defined by provisions in statutory company law. Of particular significance is the fact that company law provides for the removal of directors by ordinary resolutions passed by a simple majority of shareholders, without a showing of cause for removal, and notwithstanding anything to the

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105. *Cayne v. Global Nat'l Resources P.L.C.*, unreported, (Ch. Div. Aug. 12, 1982) (Megarry, V.C.), *aff'd on other grounds*, [1984] 1 All E.R. 225, 225 (Ct. Ap. 1982) (denying plaintiff's motion for an interlocutory injunction). Vice-Chancellor Megarry's opinion is noted in Barrett, Companies—*Issue of Shares to Preserve Existing Control—Whether Breach of Directors' Fiduciary Duties*, 56 AUST. L.J. 600 (1982).

106. See Barrett, *supra* note 105, at 600.

107. *Id.*

108. Another question raised in the British literature is whether the principle of *Hogg v. Cramphorn* applies to a target company that is the object or victim of a "Dawn Raid." A Dawn Raid is the purchase on the Stock Exchange of up to 29.9% of the company's shares at a premium price in a matter of minutes. See Lazarides, *The Fiduciary Duties of Company Directors*, 1983 LONDON L. REV. 67, 75 (Part 2). Dawn Raids, however, have been regulated since 1980 by rules that apply to acquisitions of 10% or more of a target's shares within any seven-day period, if the acquiring person will, as a result, own 15% of the voting rights in the target. These rules require that any such acquisition be made either through a partial offer recommended by the target's board and subject to the rules of the CITY CODE, or through an offer on the Stock Exchange announced at least seven days before the offer closes. See COUNCIL FOR THE SECURITIES INDUSTRY, THE RULES GOVERNING SUBSTANTIAL ACQUISITIONS OF SHARES (1985). Dawn Raids were objectionable because they enabled the purchaser to acquire either effective control or a substantial toehold at an inflated price, and then to wait for the price of target shares to drop before making an offer (at a lower price) to the remaining shareholders. If the anti-Dawn-Raid rules effectively reduce the risk that this sequence of transactions will occur, the justification for defensive share allotments by the target's board is weakened accordingly.

contrary in the company's articles or in any agreement between the company and the director.<sup>109</sup> In contrast, in the United States, the Delaware corporation statute provides that directors whose terms are staggered (so that not all directors' terms expire each year) are only removable *for cause* unless the company's certificate of incorporation states to the contrary.<sup>110</sup> This difference in statutory treatment appears to suggest that the tenure in office of British directors is inevitably more tenuous than that of their Delaware counterparts. But this apparent difference should not be overemphasized. In 1970, the House of Lords held that a provision in a company's articles that assigned multiple votes to shares held by a director only in respect of a resolution to remove him from office was valid and was not inconsistent with the statutory prescription of removal by ordinary resolution.<sup>111</sup> To be sure, British cases since 1970 mention shareholder resolutions to remove directors but do not note the existence of weighted voting protections for the directors.<sup>112</sup> Whether the non-use of weighted voting to protect directors against removal reflects more than simple inattention to the possibility is an unanswerable question.

A final point about English company law relevant to takeover transac-

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109. Companies Act, 1985, § 303(1).

110. DEL. CODE ANN. tit. 8, § 141(k) (1974). A director who has been elected through cumulative voting cannot be removed if the number of shares cast against the resolution to remove would be sufficient to elect, if voted cumulatively.

111. *See Bushell v. Faith*, [1970] App. Cas. 1099 (H.L.). The House members reached this result in a majority of the speeches by assuming that Parliament could have prohibited such a use of weighted voting had it chosen to do so. Lord Morris' dissenting speech argued that the outcome thwarted the purpose of the statutory provision by making a director irremovable and thereby made a mockery of the law. *Id.* at 1106. Lord Donovan rejoined that Lord Morris' argument necessarily assumed that Parliament "intended to cover every possible case and block up every loophole." *Id.* at 1110 (emphasis in original). He viewed that assumption as unwarranted:

[T]here may be good reasons why Parliament should leave *some* companies with freedom of manoeuvre in this particular matter. There are many small companies which are conducted in practice as though they were little more than partnerships, particularly family companies running a family business; and it is, unfortunately, sometimes necessary to provide some safeguard against family quarrels having their repercussions in the boardroom. . . .

*Id.* at 1110-11 (emphasis added). The difficulty with this argument is that the majority's position does not limit the use of weighted voting only to *some* companies, but enables all to insulate directors against removal through removal-triggered weighted voting. Nonetheless, for this device to be effective in a publicly held company, either the directors must own many shares, or the weighting factor must be spectacularly large.

112. On a not entirely unrelated matter, the Judicial Committee upheld, on an appeal from a New Zealand case, an employment contract with a managing director that entitled him to a lump sum payment equal to five times his gross annual salary, grossed up for income tax purposes, in the event of a takeover of the company. *See The Taupo Totara Lumber Co., Ltd. v. Rowe*, [1977] 3 All. E.R. 123 (P.C.).

tions is that the Companies Act, in contrast to corporation statutes in Canada and the United States, but like Australian corporation statutes, does not contain provisions that readily enable negotiated corporate mergers and acquisitions to be executed in a simple and straightforward fashion, based on the negotiation of an agreement to merge or sell assets, followed by approval from the company's directors and shareholders. Transactions in which a corporation agrees to merge with or sell all of its assets to another corporation are channelled by the Companies Act into provisions dealing with voluntary winding-up transactions. The provisions require shareholders' authorization in a general meeting, rights of dissent for shareholders, the appointment of a liquidator for the company, and an account of the winding-up from the liquidator to the public registrar of companies.<sup>113</sup> The mechanics of the takeover bid, in contrast, may be executed more simply and quickly. In short, an important facet of the transactional climate in Britain, and in Australia, is that at least some transactions which in the United States or Canada probably could be structured as negotiated mergers, are executed as takeover bids, due to the complexity and awkwardness of corporate statutory law.

### C. Canada

In general, Canadian corporate law and securities regulation pertinent to takeover regulation demonstrate the influence of both the United States and Great Britain. Geographic proximity and historical circumstance make this unsurprising. Until recently, Alberta, British Columbia, Manitoba, Saskatchewan and Ontario were "uniform act" provinces for securities regulation with substantially similar statutes, and Quebec, although not formally a uniform act province, developed compatible legislation. Statutory uniformity seems to be the legal counterpart to the Canadian view that the country has a "genuinely national capital market."<sup>114</sup> Provincial securities legislation began to diverge in 1979 with the enactment of a new securities act, now in effect in Ontario, which contains provisions regulating corporate takeovers that no other province has adopted. In other respects, however, some of the other provincial statutes are compatible with the Ontario statute.

Although the discussion that follows focuses primarily on Ontario, statutes and cases from other provinces are noted as well. Ontario's im-

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113. Companies Act, 1985, §§ 572-605.

114. See SECURITIES INDUSTRY COMMITTEE REPORT, *supra* note 12, at 5.

portance in takeover regulation is enhanced by the jurisdictional breadth of provincial securities legislation in Canada. The provincial statutes apply to takeover bids for any company, regardless of the provincial situs of its incorporation, when the bid is made by any shareholder whose last registered address on the target's books is in a particular province.<sup>115</sup> Canada also has a national corporation statute, which includes provisions regulating takeovers, applicable only to corporations incorporated under that statute.

Under the Ontario Securities Act, a "takeover bid" is defined as any offer to purchase voting securities<sup>116</sup> in the target that would, if accepted, result in the offeror owning more than twenty percent of the target's voting securities,<sup>117</sup> unless the transaction fits within a stated exemption. A takeover bid may not be made except in compliance with the statute's requirements which include a general offer to all the corporation's shareholders. The two most notable exemptions cover bids made through the facilities of the Toronto Stock Exchange ("TSE"), which are regulated separately by the TSE, and purchases made privately from fourteen or fewer stockholders. As in the United States, partial bids are freely allowed, subject to a proration requirement in the event of oversubscription and to separate timing requirements.<sup>118</sup>

In addition to requiring that significant share acquisitions be structured as "all-holders" offers at one price, the Ontario statute requires an acquiring person in some circumstances to offer to buy out the target's remaining stockholders. Under § 91(1) of the statute, an offeror who becomes the owner of more than twenty percent of the target's voting securities through a private agreement with fourteen or fewer holders

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115. The securities bar in Canada appears to view with dismay the prospect that the Ontario Securities Commission could use its considerable statutory powers to compel compliance with the Ontario legislation when the issuer involved is listed on the Toronto Stock Exchange, but is not incorporated in Ontario, and the vendors and purchasers of securities are not Ontario residents. The use of the TSE listing for this purpose has been pejoratively termed the "sandbox theory." See Coleman, *supra* note 43, at 210.

116. The Ontario statute applies to a transaction if at least one owner of the voting securities covered by the offer has a last address in Ontario on the target's books. Thus, the statute may apply to transactions completed outside Ontario. If no vendor is an Ontario resident, the statute is inapplicable unless shares were transferred to a non-Ontario resident for the purpose of avoiding the statute. See The Securities Act, ONT. REV. STAT. ch. 466, § 88(1)(d) (1980) (defining "offerer").

117. The takeover provisions of the Canada Business Corporations Act, in contrast, are triggered by acquisition of 10% of the voting securities of a CBCA company. See Canada Business Corporations Act, I CAN. STAT. ch. 33 (1974-75-76).

118. See The Securities Act, ONT. REV. STAT. ch. 466, § 89(1)(8) (1980).

(which is exempt from the general offer requirement) is obliged to make a follow-up offer to the target's remaining stockholders of the same class if there is a published market for the securities and the value of the consideration paid by the offeror under the private agreement exceeds the existing market price plus reasonable brokerage fees and other commissions.<sup>119</sup> "Market price" has been defined by the Ontario Securities Commission as "an amount 15 percent in excess of the simple average of the closing price of securities of that class for each day on which there was a closing price and falling not more than ten business days before the relevant date."<sup>120</sup> Thus, the offeror who pays a premium of less than fifteen percent to offerees in a private transaction is not subject to the statutory buyout obligation, nor, for that matter, to the mandatory bid requirement. The Ontario statute also exempts as *de minimis* acquisitions of up to five percent of the target's voting securities by the offeror and its affiliates within a twelve month period, so long as the price paid does not exceed any published market price plus reasonable fees and commissions. The availability of this exemption, however, is limited by the fact that acquisitions made through an exempt TSE bid must be counted against the five percent limit. Acquisitions made through an exempt private agreement or through a general offer to stockholders do not count against the five percent.<sup>121</sup>

The Ontario strictures on bidders are clearly the result of a concern that control premiums should be shared with all stockholders when sufficient shares to constitute effective control are bought from a small number of shareholders.<sup>122</sup> Indeed, the bidder's obligation to buy out the remaining stockholders is triggered only by the "private agreement"

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119. See *id.* at § 91(1). The follow up offer must be "at least equal in value" to the price paid under the private agreement and it must be made within 180 days of the date of the private agreement. *Id.*

120. Ontario Securities Commission, Securities Act Regulation § 163(3), in 3 Can. Sec. L. Rep. (CCH) ¶ 50-540b (1983).

121. See 2 V. ALBOINI, SECURITIES LAW AND PRACTICE § 19.3.12 (1984).

122. See, e.g., COMMITTEE TO REVIEW THE PROVISIONS OF THE SECURITIES ACT (ONTARIO) RELATING TO TAKE-OVER BIDS AND ISSUER BIDS, REPORT Nos. 15-16 (Sept. 23, 1983). This report proposed that the obligation to make a follow-up bid be eliminated from the statute and, in its stead, that "private agreements" exempt from the general offer requirement be prohibited if they involved a price in excess of 115% of the market price averaged over the 20 preceding days. *Id.* at 16. The nature of the proposed substitute for the follow-up bid—denying an exemption from the obligation to make an all-holders bid if a premium of more than 15% is paid to fourteen or fewer shareholders—makes it apparent that Ontario's narrow buyout requirement was a response to perceived inequalities surrounding sales of control shares by small numbers of shareholders. The Report's recommended substitution found its way into legislation proposed by the Ontario government,

transaction. It is not triggered by other types of transactions that may pass effective control, such as a partial bid made to all stockholders, or a bid made on the TSE.<sup>123</sup> But the most striking contrast is not among the treatments of various transactions within the Ontario statute, but between Ontario and the United States. In the United States, persons buying and selling shares are under no general obligation to structure the transaction to create an equal sharing of any control premium among all shareholders. The Ontario approach, on the other hand, results in a more integrated treatment of separate transactions that may shift control in the target company because it requires acquisitions that would give the purchaser a sizeable (i.e., twenty percent) holding to be made through a general all-holders offer. It further achieves equal treatment of target stockholders if the transaction that shifts control results from purchases from a few, presumably large, stockholders.

The buyout obligation created by the Ontario statute also contrasts with the considerably broader buyout obligation imposed by the City Code in Britain.<sup>124</sup> The City Code has a higher trigger point (thirty percent rather than twenty percent), but it is applicable to *all* acquisitions giving the acquirer thirty percent voting control.

One possible explanation for the narrower focus of the buyout obligation in Ontario is the relatively large number of Canadian companies controlled by a small number of family-identified groups.<sup>125</sup> Permitting control premiums to be paid to a small number of stockholders may seem especially unfair when, as seems likely in Canada, the vendors are repeat players receiving premiums in many such transactions. Although no other Canadian province has followed Ontario's lead in imposing a buyout obligation in the context of private sales of control, the Quebec securities legislation regulates such transactions in a style that is consistent with the concern for apparent fairness described above. Under the

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see Bill 159, an Act to amend the Securities Act, 32nd Legis., 4th Sess., (Ontario), 33 Eliz. II (1984), but did not go past its first reading due to a change in governments.

123. The current version of the Ontario statute was adopted following a 1973 study of the law pertinent to mergers. A majority of the study committee supported the retention of the exemption for private agreements from regulation as takeover bids and opposed any mandatory buy-out requirement. A minority of the committee supported the imposition of a buyout requirement when a person became the owner of 20% of the shares through a private agreement. *See 1973 REPORT ON MERGERS, AMALGAMATIONS AND CERTAIN RELATED MATTERS BY SELECT COMMITTEE ON COMPANY LAW*, 29th Legis., 3rd Sess., 22 Eliz. II (1973). *See generally Leclerc, The Sale of Control and the Ontario Follow-Up Offer*, 23 LES CAHIERS DE DROIT, No. 1, at 35 (1982).

124. *See supra* notes 94-95 and accompanying text.

125. *See supra* notes 13-15 and accompanying text.

Quebec statute, the exemption from the general obligation to make an all-holders bid if the acquiror would thereby obtain more than twenty percent of a class of voting securities is available only for purchases from fourteen or fewer holders, at a price not in excess of fifteen percent over the average market price.<sup>126</sup> The Quebec solution, then, is to require a general offer to all shareholders if a premium of more than fifteen percent would otherwise be paid to more than fourteen vendors.

Industry practice prior to the adoption of the Ontario requirement in 1981 also helps to explain its structure. Based on the TSE's records, an announcement of an offer to buy out the other shareholders accompanied traceable private agreement transactions in all but one instance. A majority of these offers were identical to the consideration in the private agreement. The remainder offered substantial, if not comparable, consideration. The one exception—where no offer to the remaining shareholders was made—met with negative reactions in the securities industry and the financial media and is thought to have added impetus for the adoption of the legal buyout requirement.<sup>127</sup> Thus, the buyout requirement in Ontario, although narrowly focused, is consistent with the financial community's private mores that preceded it.

Another facet of takeover regulation in Ontario that differs substantially from the United States is the statutory treatment of conditions in bids. Under the Ontario Securities Act, but not the Williams Act, the offeror's ability to condition its bid is limited to three types of conditions specified in the statute: 1) that a minimum number of shares be tendered; 2) that no material change in the target occur other than changes caused by the offeror; and 3) that all required governmental approvals be forthcoming.<sup>128</sup> In contrast, Britain's City Code as described above, rather than specifying permissible conditions, prohibits conditions in which fulfillment turns on the offeror itself or its subjective judgment.<sup>129</sup> Finally, the Ontario legislation grants more limited withdrawal rights than does the Williams Act.<sup>130</sup>

The legal position of target management in Canadian corporations also

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126. See The Securities Act, 1982 Que. Stat. ch. 48, § 116(1) (1982). This section of the statute limits the private purchase exemption to bids made "at a price limited to the margin established by regulation . . ." The price limit has been set by regulation at 15% over the average closing quotation over the ten trading days preceding the bid. Que. Sec. Act. Regulations § 187.

127. See SECURITIES INDUSTRY COMMITTEE REPORT, *supra* note 12, at 32.

128. See The Securities Act, ONT. REV. STAT. ch. 466, § 89(1)(12).

129. See *supra* text accompanying note 88.

130. The Ontario statute permits shareholders to withdraw shares within the first ten days after

shows the influence of British and United States law. Like the Williams Act in the United States, the Canadian securities statutes, with one exception, do not directly regulate defensive transactions. The constraints on target management as a result stem from statutory company law and common law interpretations of the fiduciary obligations owed to the company by its management. A basic limitation on directors' positions is the same as that established in Britain: under Canadian corporation statutes directors are always removable through a shareholder vote by ordinary resolution, subject to the protection of cumulative voting rights.<sup>131</sup> On the other hand, the Canada Business Corporations Act does not require a corporation to stipulate in its articles any authorized capital.<sup>132</sup> Thus, directors of CBCA corporations that have not specified an authorized capital are free to allot additional shares.<sup>133</sup>

The one limitation in Canadian securities regulation that affects defensive transactions concerns the regulation of issuer bids (in the U.S. parlance, "self-tenders") and, specifically, an issuer's ability to make an offer to repurchase its own shares that excludes specified stockholders—in particular a hostile bidder. In the United States, courts have held that a selective or discriminatory issuer tender offer does not violate the Williams Act<sup>134</sup> and that target directors, having authorized such an offer,

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the bid is made but does not grant additional withdrawal rights if a competing bid is made. *See* The Securities Act, ONT. REV. STAT. ch. 466, § 89(1), 4; 2 V. ALBOINI, *supra* note 121, at 19-57 (1984).

131. *See, e.g.*, Ontario Business Corporations Act, § 122(1), ONT. STAT. (Ch. 4, 1982). Directors elected exclusively by a class or series of shares are removable only by an ordinary resolution passed by holders of that class or series. *Id.*

One question about removal of directors in Canada is whether directors can be protected against that risk by holding shares with a weighted voting feature triggered solely by a resolution for removal, a possibility validated under the British Companies Act, 1948 in *Bushell v. Faith*. *See supra* note 111. A possible limitation is § 22(3) of the Ontario corporation statute, which provides that, where a corporation has only one class of shares, "rights of holders thereof are equal in all respects and include the rights, (a) to vote at all meetings, . . ." The Ontario statute also permits articles to authorize the creation of shares in classes or series and to authorize directors to fix their number, rights and attendant restrictions. *See* Ontario Business Corporations Act § 25(1), ONT. STAT. (Ch. 4, 1982). Further, CBCA § 6(4) specifies that a corporation's articles cannot require a greater number of shareholder votes to remove a director than would be required for an ordinary resolution. The Canadian literature recommends other techniques for insulating directors against the risk of removal. One Canadian authority mentions corporate cross-ownership of shares as a way to protect directors against removal by shareholders. *See* Iacobucci, *Planning and Implementing Defenses to Take-over Bids: The Directors' Role*, 5 CAN. BUS. L.J. 131, 143 n.39 (1981). The same authority also mentions the limitation of shareholders to a maximum vote regardless of the number of shares held. *Id.* at 149.

132. *See* Canada Business Corporations Act, 1975 CAN. STAT. ch. 33, § 6(1)(c).

133. This aspect of the CBCA has been criticized. *See* Iacobucci, *supra* note 131, at 147.

134. *See* Unocal Corp. v. Pickens, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶92,296

may be protected by the business judgment rule.<sup>135</sup> If the target is able to exclude shares held by a hostile bidder from its offer, the cost of making its self-tender offer is reduced for the target, while the hostile bidder, after the self-tender, holds shares in a target corporation with fewer liquid assets or more debt (incurred in order to finance the self-tender) or both. In contrast, this technique is not available to targets under the Ontario securities statute. That statute requires that all takeover bids, including issuer bids, "be sent to all holders of the class of securities sought . . ."<sup>136</sup> True, the statute does not expressly require that the offer be *made* to all holders, but the "sending" requirement seems substantially the same. The SEC, in the United States, recently used its rule-making power to prohibit selective issuer and third party offers.<sup>137</sup>

Directors of Canadian corporations, like their counterparts in Britain and the United States, hold their powers—including the power to repurchase shares and the power to allot additional shares—subject to the fiduciary obligation to exercise them only in what the directors bona fide consider to be the company's best interests. In the leading (and widely cited) Canadian case, *Teck Corporation Ltd. v. Millar*,<sup>138</sup> the British Columbia Supreme Court rejected the principle of *Hogg v. Cramphorn*, holding that "the directors ought to be allowed to consider who is seeking control and why . . . the exercise of their powers to defeat those seeking a majority will not necessarily be categorized as improper" if the directors believe substantial damage to the company's interests would otherwise ensue.<sup>139</sup> In *Teck Corporation*, the directors of a mining corporation with an unexploited copper property signed an exploitation contract with a major mining company giving it the right to a thirty percent equity position in the company owning the copper mine. The effect of

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(C.D. Cal. May 1, 1985) (denying motion for preliminary injunction against completion of self-tender offer with exclusionary condition).

135. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

136. The Securities Act, ONT. REV. STAT. ch. 466, § 89(1).

137. See Rule 14d-10, 51 Fed. Reg. 15874 (1986) (to be codified at 17 C.F.R. 240.14-1-14d-10); and Rule 13e-4, 51 Fed. Reg. 15874 (1986) (to be codified at 17 C.F.R. 240.13e-4).

138. 33 D.L.R. 3d 288 (1972).

139. *Id.* at 315. This language should recall that of Vice Chancellor Megarry in *Cayne v. Global Natural Resources P.L.C.*, see *supra* text accompanying note 105. The connection is that the Vice Chancellor's opinion in *Cayne* cites *Teck Corporation* as support for its proposed limitation of *Hogg v. Cramphorn*. To a reader in the United States, a striking feature of this entire body of cases is the endurance of the British commonwealth in complementary and cross-citing legal authorities, in an era in which the commonwealth as a trading union has weakened, and its perpetuation in formal sovereignty relationships has been vitiated as well.

the prospective share allotment would have been to reduce below a legal majority the shareholdings of another mining conglomerate that had, prior to the signing of the exploitation contract, acquired a majority shareholding in the company with the copper property, with the expressed intention of contracting to exploit the mine. The court believed the target's directors were motivated by a desire to make the best contract for exploitation that they could for their company. The court then noted that the directors had considered the respective experience and success in the mining industry of the two contestants for control and had chosen the one they believed most likely to develop the property efficiently and profitably.<sup>140</sup> Indeed, this view of the directors' motivation enabled the court to distinguish *Hogg v. Cramphorn* as applying to facts in which the directors' primary purpose was to frustrate a takeover rather than, as in *Teck Corporation*, to make the best possible deal for their company. The *Teck Corporation* court also explicitly rejected the position stated in *Hogg v. Cramphorn* that directors' powers may not be used to frustrate an attempt to take control of the corporation on the basis that the limitation on directors' power stated in *Hogg* could not be limited to share allotments. The relevant criterion according to the *Teck Corporation* court, is the directors' purpose and the propriety or impropriety of that purpose, which "does not depend on the nature of any shareholders' rights that may be affected by the exercise of the directors' powers."<sup>141</sup>

*Teck Corporation* thus represents a view of target directors' actions that gives primacy to motivation rather than to the *Hogg v. Cramphorn* conception of shareholders' "constitutional" rights to acquire voting control. One palpable difference in result between these two approaches is the nature of the task imposed on the court that must apply the test to evaluate the directors' conduct: the test based on motivation adopted in *Teck Corporation* requires extensive review of the factual context surrounding the transaction—an exercise that is unnecessary if a case can be resolved based on conceptions of shareholders' rights as in *Hogg*.<sup>142</sup>

Another possible constraint on target directors of Canadian corpora-

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140. 33 D.L.R. 3d at 330-31.

141. *Id.* at 312. *But see Coleman v. Myers*, [1977] 2 N.Z.L.R. 298 (suggesting that directors owe a general fiduciary duty to shareholders).

142. A measurable consequence of this difference is the length of judicial opinions applying the two tests: the court's opinion in *Hogg v. Cramphorn* is 10 pages, whereas in *Teck Corporation* it is 43 pages!

tions (albeit one that does not appear to have been used thus far in litigation over takeovers in Canada) stems from the statutory remedies for corporate conduct "that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation. . . ."<sup>143</sup> The Ontario corporation statute authorizes the court to make an order to rectify such conduct, including conduct that "threatens to effect" such a result, and broadly defines the type of orders the court may make.<sup>144</sup> Awaiting further development in the case law is the distinction, if any, between defensive transactions undertaken for an improper purpose under the test stated in *Teck Corporation* and defensive transactions that under the statute are "oppressive or unfairly prejudicial" or that unfairly disregard the interest of a security holder. A potential point of tension is between the assumption in *Teck Corporation* that directors' duties are owed solely to "the company," and the assumption in statutory oppression remedies that actions undertaken by directors on behalf of "the company" may improperly infringe on obligations owed to shareholders. In any event, a practical constraint on many target and potential target directors is the requirement of the Toronto Stock Exchange that listed companies give the TSE immediate notice of each proposed option or issue of treasury securities. Under its bylaws, the TSE may require shareholder approval of the transaction as a condition of accepting the notice.<sup>145</sup>

#### D. Australia

Although Australian corporate law and securities regulation is unique in many respects, the treatment of takeover-related issues somewhat re-

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143. See, e.g., Ontario Business Corporations Act § 247, Ont. Stat. (Ch. 4, 1982).

144. See *id.* § 247(3). See generally Kaufman, *Oppression Remedies: Recent Developments*, in 3 CORPORATE STRUCTURE, FINANCE AND OPERATIONS 67 (L. Sarna ed. 1984); Beck, *Minority Shareholders Rights in the 1980's* in SPECIAL LECTURES OF THE LAW SOCIETY OF UPPER CANADA: CORPORATE LAW IN THE 80S 311 (1982).

145. Shareholder approval, under the bylaw, may be required if "in the opinion of the Exchange" the proposed transaction may materially affect control of the company, or the transaction has not been negotiated at arm's length, or it "is of such a nature to make shareholder approval desirable, having regard to the interests of the company's shareholders and the investing public." TORONTO STOCK EXCHANGE, GENERAL BY-LAW § 19.06(2). In contrast, in the United States, the New York and American stock exchanges have adopted bright-line tests for share allotments that require shareholder approval. The New York exchange requires shareholder approval for any option or share allotment that would increase the issuer's outstanding common shares by 18.5%. See NYSE COMPANY MANUAL A-283. The comparable limitation on the American exchange is 20%. See AMEX COMPANY GUIDE § 7.3.

sembles other Commonwealth systems and the United States. Corporate takeovers are regulated by the Companies (Acquisition of Shares) Act of 1980 ("CASA"), a federal statute adopted by each of the Australian states. CASA, a much lengthier and much more detailed statute than its counterpart legislation in the United States and Canada, confers enforcement authority on the National Companies and Securities Commission ("NCSC") and makes applicable all of the remedial provisions in the Companies Code. CASA also gives the NCSC power to determine that, in light of the statute's purposes, parties' acquisitions of shares or other activities are "unacceptable" notwithstanding literal compliance with CASA itself, and power to apply to a court for orders appropriate to protect the rights of interests involved.<sup>146</sup> In this respect, the NCSC's posture under CASA resembles the stated position of the Take-Over Panel in Britain. The City Code states that the Code's "spirit as well as the precise wording . . . must be observed" by participants in take over contests.<sup>147</sup>

Like the Ontario legislation, CASA in essence defines a closed system with stated exceptions: under CASA, any acquisition that would give the acquiring person, together with his associates, twenty percent or more of the target's voting securities must be made either through a general offer to all shareholders or through a regulated stock exchange bid.<sup>148</sup> Nonetheless, at least in some circumstances litigation has tested and found wanting the NCSC's powers to compel an offeror to proceed with an offer.<sup>149</sup> Significant exceptions for our purposes from the general bid requirement created by CASA are: 1) acquisitions of shares in a company that has fewer than fifteen shareholders,<sup>150</sup> and 2) acquisitions that have been approved at a shareholders' meeting by a majority of the target's shares, excluding from the vote shares held by the prospective acquiror and its associates.<sup>151</sup>

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146. See Companies (Acquisition of Shares) Act 1980, AUSTL. C. ACT § 60 (Supp. 1978-83) [hereinafter CASA].

147. See CITY CODE, *supra* note 84, General Principles, Introduction.

148. See CASA, *supra* note 146, at § 11. For a discussion of the definitional sections of CASA, see Deutsch, *Takeovers and the Scope of the Companies (Acquisition of Shares) (N.S.W.) Code*, 11 AUSTL. BUS. L.J. 205 (1983).

149. In N.C.S.C. v. Indus. Equity Ltd., [1982] 1 A.C.L.C. (Sup. Ct. N.S.W.), the court held that the N.C.S.C. lacked statutory power to compel an offeror to proceed with an offer, in very complicated circumstances involving, *inter alia*, an arguable breach of CASA § 11.

150. See CASA, *supra* note 146, at § 13(1). This exception is inapplicable if the exempt acquisition would contravene § 11 with regard to the shares of another company.

151. See *id.* § 12(g).

Like the Ontario statute CASA contemplates the possibility of tender offers made through a stock exchange, but CASA, unlike the Ontario statute, regulates such offers in great detail. CASA restricts in some aspects an offeror's ability to condition its bid.<sup>152</sup> CASA does not require a follow-up bid and regulates partial offers by requiring that they be made on a proportional basis.<sup>153</sup> Thus, in contrast to the Williams Act in the United States, but paralleling the Ontario Securities Act, CASA requires that sizeable share acquisitions, or at least those giving the acquiring person twenty percent of the target's voting power, be made through a general offer to all shareholders. In contrast to the Ontario legislation and the City Code in Britain, CASA does not treat such sizeable acquisitions as events triggering an obligation on the part of the acquiring shareholder to offer to buy out the target's remaining shares. In this respect, the operative norm of equity in CASA is an equality of opportunity rather than equality of treatment. Finally, unlike all the other regulatory systems, CASA grants no withdrawal rights to shareholders.<sup>154</sup>

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152. CASA, although it defines in § 6 a set of conditioning events or "prescribed occurrences" concerning the target, can be read not to *limit* the offeror to those specified conditions. *See H. FORD, COMPANY LAW 520* (3d ed. 1982). CASA also forecloses the offeror's ability to make market purchases during the bid if the offer is subject to conditions other than those specified in § 13(4)(b), which are the "prescribed occurrences" for the target, minimum acceptable conditions and any other conditions approved by the commission. The "prescribed occurrences" include a number of events that would reduce the value of the target's assets or increase the number of target shares outstanding. The N.C.S.C. has issued a general policy statement concerning conditions in bids that acknowledges that the scope of § 13(3) & (4) is limited to circumstances in which the offeror desires to assert additional conditions and buy on the market. *See N.C.S.C. Policy Statement, approval of conditions Release No. 107 (1985).*

153. *See CASA, supra* note 146, at §§ 16(2)(a), 16(s)(f)(iii). The regulation of partial bids has recently been under discussion in Australia, at least in part because 40% of recent offers have been partial bids. The Ministerial Council adopted the recommendations of the Companies and Securities Law Review Committee that bidders making partial offers be required to make them on a proportional rather than a prorated basis. *See CASA, supra* note 146, §§ 16(2)(a), 16(2)(f)(iii); *see generally COMPANIES AND SECURITIES LAW REVIEW COMMITTEE, REPORT TO THE MINISTERIAL COUNCIL ON PARTIAL TAKEOVER BIDS* (August 1985). The statute was further amended in 1986 to permit a company, in its constituent documents (i.e., its articles), to require that any partial bid for its shares be subject to approval or disapproval by a shareholder plebiscite. *See CASA, supra* note 146, § 31A. But the stock exchanges have threatened to delist companies that adopt these plebiscite provisions, despite statutory language providing for plebiscites "not notwithstanding anything in the business or listing rules of the exchange." *See Potter, Plebiscite Stance likely this week, Aust. Fin. Rev.*, Oct. 1, 1986, at 27, col. 1. Nonetheless, the exchanges were reported to be unlikely to confront their largest listed company (BHP) over its adoption of a plebiscite requirement for partial bids. *See The Age*, Oct. 1, 1986, at 29, col. 4.

154. Whether the absence of withdrawal rights in itself inhibits the appearance of competing bids is an open question. At least some Australian observers believe that their absence means only that shareholders wait until the proverbial last moment in order to tender, awaiting until the very end of

An additional aspect of the corporate legal context in Australia that defines the acquisition environment is the lack in the Australian corporate statutes of any provisions readily enabling negotiated corporate mergers or amalgamations. Thus, in contrast to Canada and the United States, but like Britain,<sup>155</sup> Australia makes effecting a negotiated merger between two companies difficult to achieve through the mechanisms set forth in the corporation statute itself, a fact that must be relevant to the popularity of the device of the takeover bid.<sup>156</sup> Finally, unlike the Williams Act and the Ontario securities legislation, CASA requires that the offer document be registered with the Securities Commission prior to its transmission to offeree shareholders, even if the consideration offered in the bid is exclusively cash.<sup>157</sup>

The powers of target company directors in Australia are, on balance, more limited by aspects of Australian statutory corporate law than are their counterparts' powers under the other corporation statutes reviewed in this Article. Greater similarity obtains for the fiduciary constraints upon directors' exercise of those powers.

Under the Australian Companies Code, a corporation's directors are

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any bid's duration the appearance of a competing bid. Other observers differ. *See* Coffee, *supra* note 46, at 233-34. A separate-and separable-question is the significance of additional withdrawal rights specifically triggered by the appearance of a competing bid. Such rights are created in the United States by the SEC's Rule 14d-7(a)(2) under the Williams Act. 17 C.F.R. 240.14d-7(a)(2). They not only permit shareholders to withdraw, they prolong the contest and enhance the prospect of successive bid topping. Additionally, CASA § 31 provides that if the offeror makes purchases outside the bid at a higher price, the terms of the bid shall be deemed to be varied to offer the higher price.

155. For a discussion of the British materials, see text accompanying note 113 *supra*. The Ontario statute authorizes corporations to amalgamate, on the basis of an agreement entered into by each corporation. The amalgamation agreements must then be submitted to a shareholder meeting by the directors of each corporation and approved by special resolution of the holders of each class or series entitled to vote thereon. Ontario Business Corporations Act §§ 174-75, Ont. Stat. (Ch. 4, 1982). "Special resolutions" under this statute require a 2/3 majority vote to pass. *Id.* at § 1(43).

156. Under the Australian Companies Code, a "compromise or arrangement" requires court approval and approval by 75% of the shareholders or class of shareholders if the "arrangement" is with only one class. Companies Code, 1981, AUSTL. C. ACTS § 315 (Supp. 1978-83). The "compromise or arrangement" section includes reconstructions or amalgamations with another company and requires court approval for all such transactions. *Id.* at § 317.

157. *See* CASA, *supra* note 146, § 16(2)(e). In the United States, prior registration with the SEC would be required if the consideration being offered is securities, for then the registration and prospectus requirements of the Securities Act of 1933 would be implicated. Otherwise, no registration requirement applies to tender offers. In Ontario, although it is customary to file take-over circulars with the OSC on the same day they are dispatched to offerees, *see* 2 V. Alboini, *supra* note 121, at 19-105, and although prospectus-type disclosure is required if the consideration offered by the bid is securities, *see id.* at 19-104, registration is not required and the OSC will review the contents of the bid circular only under very narrow circumstances, *see id.* at 19-8.

removable by ordinary resolution "notwithstanding anything in its articles or in any agreement. . . ."<sup>158</sup> Whether this language is sufficient to exclude the possibility of protecting directors against removal through removal-triggered weighted voting shares appears to be an open question under the Australian statute, although, as we have seen, the validity of such voting rights has been upheld in the face of similar language in the British Companies Act.<sup>159</sup> An additional limitation stems from the absolute statutory prohibition on corporate share repurchases, which are a crime in Australia.<sup>160</sup> Until recently, Britain also prohibited corporate share repurchases. Australian statutes permit companies to lend financial assistance to others purchasing their shares only if three-fourths of the shareholders vote by special resolution to approve the transaction.<sup>161</sup> In contrast, in Britain, although such assistance is prohibited, a company may justify giving lending financial assistance if its primary purpose is incidental to some larger purpose of the company itself. Together, these two aspects of Australian company law preclude defensive share repurchases and issuer tender offers, while subjecting to shareholder approval—at a high threshold—defensive transactions in which the target enlists the support of a favored bidder by permitting the use of its assets and earnings to repay the favored bidder's financing for its offer. The basic position in Australia, then, would be that defensive use of the leveraged buyout transaction is not an option.

But Australian securities professionals are easily as adept<sup>162</sup> as their

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158. See Companies Code, 1981, *supra* note 157, at § 225 (1981).

159. See *supra* text accompanying note 111.

160. See Companies Code, 1981, *supra* note 157, at § 129(1)(b) & (5). Until relatively recently, the British Companies Acts contained the same prohibition, apparently grounded in the view that the company's capitalization in common stock represents an ongoing and irreducible representation to its creditors. In Britain, the Companies Act, 1981 permitted an issuer to repurchase its own shares if procedures set forth in the statute were followed, subject to shareholder approval of the transaction by ordinary resolution. See Companies Act, 1981 §§ 46-49. The Companies Act, 1985 carries over these provisions. See Companies Act, 1985 §§ 162-69.

161. See Companies Code, 1981, *supra* note 157, at § 129(10)(a) (1981). In Britain, the Companies Act, 1981, likewise prohibited companies from lending financial assistance for the purchase of their own shares, but transactions were excepted from the prohibition if the company's "principal purpose" in giving the assistance was not to give it for the purpose of the acquisition but as an incidental part of some larger purpose of the company, and if the assistance was given in good faith in the company's interests. Companies Act, 1981, *supra* note 157, at § 42(1), (3). The bar on financial assistance was also not violated by a company's repurchase of its own shares. *Id.* § 42(5)(g). These rules are now part of the Companies Act, 1985 §§ 151-53.

162. The greater complexity of the relevant Australian statutes suggests, if anything, a higher degree of cleverness.

brothers and sisters elsewhere, and at least two caveats to the basic position must be noted. First, the statute itself exempts from its strictures "the payment of a dividend by a company in good faith and in the ordinary course of commercial dealing." This suggests one route through which reserves could be drawn out of the target and into the coffers of an acquiring party.<sup>163</sup> Second, if a bidder initially, based on its own financing, buys shares in the target and then sells them to an entity favored by the target's management to become the company's new controlling shareholder, it is not unimaginable that the target's assets might ultimately be used to repay the "moral debt" owed to the initial bidder.

The fiduciary constraints on Australian directors' exercise of their corporate powers developed in the Commonwealth legal context shared with Britain and Canada. In *Howard Smith Ltd. v. Ampol Petroleum Ltd.*,<sup>164</sup> an appeal from the Supreme Court of New South Wales to the Judicial Committee,<sup>165</sup> the directors of a target company had issued a large block of shares to a preferred bidder. This destroyed the majority position of the rival bidder, which had made a bid for the remaining shares in the company that its directors considered too low and that was ultimately topped by a higher bid from the preferred bidder (and recipient of the

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163. See Companies Code, 1981, *supra* note 157, at § 129(8)(a). Indeed, the Australian literature expressly discusses the dividend route as a way to decrease the acquiring party's costs. See Gonski & Keenan, *supra* note 93, at 232. On the other hand, if the acquisition were made through a partial bid, so that dividend payments must be made to other shareholders in addition to the bidder, the target's assets will be reduced by a greater proportion than the reduction in the offeror's effective costs—a phenomenon termed "leakage" of assets. *Id.*

164. [1974] A.C. 821 (P.C.).

165. In 1975, Australia abolished the right of appeal to Privy Council from judgments of its High Court; likewise, there is no appeal as of right from judgments of the state supreme courts to the High Court. In consequence, the number of appeals brought to Privy Council from the supreme courts has increased. In effect, since 1975 there have been two courts of ultimate appeal from judgments of the supreme courts. This has led in some instances to conflicting precedents binding on a state's supreme court. Some Australian litigants apparently find it cheaper—or for other reasons preferable—to appeal from judgments of single state supreme court judges to Privy Council than to appeal to the full supreme court and then seek special leave to appeal to the High Court, and some litigants institute appeals to Privy Council at the same time as applying for special leave to appeal to the High Court. See Gibbs, *The State of the Judicature*, 59 L. INST. J. 968, 970 (1985). Indeed, one Australian judge has observed that "the law of New South Wales is growing relatively more quickly in London than in Canberra." *Id.* But this situation will not continue indefinitely: agreement has been reached among the Australian Commonwealth, the States and British authorities to abolish the remaining right of appeal to Privy Council. *Id.* Former Chief Justice Gibbs of Australia's High Court, although acknowledging with regret the impending rupture of the tie between British and Australian lawyers, nonetheless emphasizes "the urgency of the need to close this chapter in our judicial history." *Id.*

share allotment).<sup>166</sup> The Judicial Committee held that it was improper for the directors to use their power to allot shares purely for the purpose of destroying an existing majority or creating a new majority, because by doing so the directors “interfered with that element of the company’s constitution which is separate from and set against their powers. . . ,” namely the individual shareholders’ right to dispose of shares at a given price.<sup>167</sup> While *Howard Smith* explicitly rejects the argument that the dispute must be decided in favor of the corporation’s directors once it is shown they were not motivated by self-interest,<sup>168</sup> it also rejects the argument that the only proper purpose for which shares could be issued is to raise fresh capital, stating that the power should not be understood to be so narrowly limited.<sup>169</sup>

Curiously enough, after discussing the opinion in *Teck Corporation* and the Canadian court’s conclusion that the share allotment in that case was proper because its primary purpose was to obtain the best possible deal for the company, the *Howard Smith* opinion concludes that *Teck Corporation* “appears to be in line with the English and Australian authorities to which reference has been made.”<sup>170</sup> But one English authority to which *Howard Smith* refers is *Hogg v. Cramphorn*, whose rationale was specifically rejected by the British Columbia Supreme Court in *Teck Corporation*.<sup>171</sup> Further, although the transactional contexts in *Teck Corporation* and *Howard Smith* were different (for one thing, the bidding battle in *Teck* was in part over the bidders’ respective abilities to develop the target company’s copper mine), they are not so utterly dissimilar to reconcile the cases’ rationales.<sup>172</sup>

The current strength of the legacy of *Howard Smith* is difficult to assess. Although the case has not been overruled, one recent Australian

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166. [1974] App. Cas. at 823-24.

167. *Id.* at 837. In an earlier Australian case, *Mills v. Mills*, 60 C.L.R. 150, 185-6 (Austl. 1938) the emphasis of the court’s analysis is instead on the substantial object the company’s directors sought to achieve.

168. [1974] App. Cas. at 834.

169. *Id.* at 835.

170. *Id.*

171. It may nonetheless be too much to state that *Howard Smith* thereby takes the position that *Hogg v. Cramphorn* was wrong, see Lazarides, *supra* note 108, at 78, because the treatment of *Teck Corporation* in *Howard Smith* is simply too brief to support such a strong reading.

172. To be sure, the judgment reviewed by the Judicial Committee in *Howard Smith* contained a specific finding that, assuming the target company to be in need of raising more capital, issuing debentures rather than shares would have been more appropriate for it. *Ampol Petroleum Ltd. v. R.W. Miller (Holdings) Ltds.*, [1972] 2 N.S.W.L.R. 850, 872.

case appears to depart somewhat from its reasoning. In *Pine Vale Investments Ltd. v. McDonnell and East Ltd. and Anor.*,<sup>173</sup> Pine Vale controlled about twenty-six percent of the shares in McDonnell and East, and had announced a partial takeover bid for McDonnell. Pine Vale, however, had not made a formal offer when McDonnell and East, to finance the acquisition of another business, proposed to issue rights to buy additional McDonnell shares to all of its shareholders. The effect of the proposed rights issue on Pine Vale would be to increase its cost in making a takeover offer for McDonnell and East, because more shares would be outstanding if the rights were exercised by other shareholders, as well as to increase the value of McDonnell and East's assets. The court rejected Pine Vale's application for an injunction, finding that McDonnell's directors were genuinely convinced their acquisition was in the company's best commercial interests and that the proposed transactions by McDonnell were not disadvantageous to the shareholders as a whole. Although the court thought it relevant that these transactions occurred at the time of Pine Vale's proposed takeover, it held this coincidence was not necessarily fatal to the legal position of the target's directors. In the court's view, the directors' duties were owed to the company as a whole and not to individual shareholders, and no individual shareholder could be shown to be discriminated against by the proposed transactions. The difference between *Pine Vale* and *Howard Smith* is in part that these opinions emphasize different things: the perceived commercial logic of the target's proposed transaction rather than the rights of the shareholders and prospective offeror. This in turn suggests a willingness in Australian courts to consider target directors' statements of business justification and purpose in the takeover context for transactions that also have a defensive effect. Nonetheless, no Australian case to date has legitimated directors' use of their power to defend against a hostile bid based simply on their judgment that the bidder's prospective control would be bad for the company.

CASA and the rules of the AASE also regulate the defensive use of share allotments. CASA requires shareholder approval to exempt from the requirement that a general "all-holders" bid be made, any issuance of shares to a party who thereby becomes the holder of twenty percent or more of the issuer's voting securities.<sup>174</sup> Thus, if a target's directors seek to place a block of shares with a likely ally in the event a hostile offer is

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173. (1983) 8 A.C.L.R. 19, 1 A.C.L.C. 1294 (Sup. Ct. Queens).

174. See CASA, *supra* note 146, at § 12(g).

made, or if they seek to entice a friendly offeror into a bidding contest by issuing it a sizable block of shares, the issuer's shareholders must vote to approve the transaction if the transferee of the shares would, as a result, hold twenty percent or more of the issuer's voting securities.<sup>175</sup> The rules of Australian stock exchanges also require shareholder approval for any additional allotment of shares other than on a proportional basis to existing shareholders, once directors of the issuer have received notice of an actual or potential offer and for three months thereafter.<sup>176</sup>

The significance of the AASE requirement must, however, be assessed in light of the actual transactional environment in Australia in which many partial bids are made. CASA does not require shareholder approval for allotments of less than twenty percent and the AASE rule does not require shareholder approval for the additional allotment if it is made *pari passu* to all present shareholders. Either an allotment of less than twenty percent or a *pari passu* allotment to present shareholders can severely disrupt the arithmetic of a partial bidder. As an example, the rights issue in *Pine Vale* offered 1.5 million shares to McDonnell's shareholders at three dollars per share; the unwelcome bid was for 500,000 shares at six dollars each. The court believed it "wholly impossible" that the bidder would persist with its offer.<sup>177</sup>

A few additional legal constraints on Australian targets are noteworthy. CASA permits the Supreme Court to void agreements for compensation for loss of office entered into by the target with its officers or directors in contemplation of a takeover, unless the agreements are approved by a shareholder vote in general meeting at which the beneficiaries do not vote for the resolution.<sup>178</sup> Finally, the NCSC has taken the position that its power under CASA to declare conduct unacceptable could embrace declarations concerning defensive transactions. This would include a target's declaration of an unusual dividend in the course

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175. In contrast, the Ontario statute, although it bears certain structural similarities to CASA, does not seem to require that a defensive placement of shares be interpreted as a "takeover bid" to which the requirement of a general all-holders offer would be applicable. Even though § 88(1)(k)(ii) of the Ontario statute defines "take-over bid" to include acceptances of offers to sell, the statute also excepts in § 88(2)(c) offers to purchase through agreements with fewer than fifteen security holders. See *The Securities Act, ONT. REV. STAT. Ch. 466*, § 88(1)(k)(ii), (2)(c). See also 2 V. ALBOINI, *supra* note 121, at § 19.2.11 (1982) ("take-over bid" interpreted not to encompass purchase of treasury shares from issuer); *id.* § 19.1.11 (general discussion of available defensive tactics including share allotments to friendly parties).

176. AASE OFFICIAL LIST REQUIREMENT § 3R(3).

177. See (1983) 8 A.C.L.R. at 208.

178. CASA, *supra* note 146, at § 50.

of a takeover bid.<sup>179</sup> Taken together, and contrasted with Canada and the United States, all of these provisions restrict the ability of target directors in Australia to defend against unwelcome takeover bids. Again, however, the ingenuity of their advisors is considerable. For example, convertible notes issued to friendly parties appear to be used with increased frequency as defensive measures, with indentures structured to include a clause making the notes convertible into common shares during a takeover of the issuer.<sup>180</sup> On the other hand, the securities bar is reported to have had difficulty in developing "shark repellent" language for articles amendments that would be acceptable to an Australian stock exchange.<sup>181</sup>

#### IV. TECHNICAL ISSUES

This section of the Article explores three more technical questions about the regulation of takeovers that are currently at issue in some, if not all, of the regulatory systems discussed and contrasts each system's resolution of these questions. These issues are: 1) transactions prior to, or contemporaneous with, or instead of, a formal takeover bid; 2) the treatment of equity securities with lesser voting rights in takeover transactions; and 3) difficulties in the implementation of mandatory offers.

##### A. Non-Bid Transactions

One question raised by each of the regulatory systems discussed in this Article is the extent to which the system requires an integrated treatment of a series of separate transactions that cumulatively may have the effect of shifting control of a company. In the absence of such a requirement, a prospective acquiror may move quickly, and perhaps anonymously as well, through stock exchange and private transactions to accumulate shares at prices not available to shareholders other than the vendors in those transactions. Different dimensions of this underlying question arise in the United States, Canada and Australia.

In this connection the only current constraint in the United States on offerors is a prohibition on purchasing shares other than through the offer itself once a tender offer has been announced and while the offer is

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179. See H. FORD, *supra* note 152, at 536.

180. See O'Bryan, *New Court Requirements Can Make Takeovers "Absurdly Complex,"* 59 LAW INST. J. 74, 75 (1985).

181. See Gonski & Keenan, *supra* note 93, at 253 n.43.

outstanding. Otherwise, the offeror is free to precede or follow a tender offer with share acquisitions—whether through private purchases or stock exchange transactions—at a price or for a consideration different from that of the general tender offer. Partial offers are not discouraged and, apart from the proration requirement described above, are not subject to special regulatory treatment. Indeed, a controlling position may be acquired in the United States without making any general offer to stockholders. Although federal courts in a few cases have been willing to characterize selective purchasing campaigns that resulted in acquisitions of substantial blocks of shares as “tender offers” to which the Williams Act applied, most cases and all recent cases have declined to so interpret the reach of the statute.<sup>182</sup> In effect, current law in the United States takes an atomistic view of formally separate transactions that cumulatively may shift control, so long as a formal tender offer is not made to the target’s shareholders.

The atomistic view ascribed above to the United States is not shared by the other systems reviewed by this Article. In Canada and Australia, problems of linking or integrating transactions may arise. For example, under the Ontario statute, although an acquisition of shares that would give the acquiring person control of twenty percent or more of the target’s stock must be made as an all-holders bid, pre-bid purchases up to the twenty percent threshold are freely permitted, in theory. Other aspects of the Ontario regulatory system, however, require that this theoretical possibility be modified somewhat. First, it will be recalled that the Ontario statute requires a take-out bid to the remaining shareholders if the acquiror attains control of twenty percent or more of the target’s voting rights through a private transaction in which a premium of more than fifteen percent over market was paid. If pre-bid market purchases are followed by pre-bid private transactions, the target’s shareholders or the Ontario Securities Commission (OSC) staff may argue that the market purchases raised the market price, so that the price paid in the private transaction exceeded the allowable premium and triggered an obligation to make a follow-up bid.<sup>183</sup> Second, the OSC has taken the position that if an acquiror offers to purchase all the securities of one owner, any

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182. See, e.g., *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 57-58 (2d Cir. 1985); *Kennecott Copper Corp. v. Curtis-Wright Corp.*, 449 F. Supp. 951 (S.D.N.Y.), *aff’d in relevant part*, 584 F.2d 1195, 1206-07 (2d Cir. 1978); *S.E.C. v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 949-53 (9th Cir. 1985).

183. See Coleman, *supra* note 43, at 176.

“linked” or “related” takeover bid must be at a price at least as great as that offered in the private agreement.<sup>184</sup> That is, if the all-holders bid is “linked” to the private agreement, even if the private agreement does not trigger a buyout obligation, the purchaser has an obligation to offer an equal price to all holders of the same class of security. The rationale for this position is the statutory requirement that all holders be offered the same consideration.<sup>185</sup> Whether the takeover bid can be shown to be “linked” to the private purchase depends on proof of the purchaser’s intention at the time of the private purchase. Relatedly, the OSC does not permit private purchase agreements by offerors during the course of a takeover bid.<sup>186</sup>

The Australian dimension of this problem has arisen because CASA, although it does not impose any obligation to make a follow-up bid, requires acquisitions that will give the purchaser twenty percent voting control of the target to be made through a bid to all shareholders or through a regulated stock exchange bid. In one case before the NCSC, Company *A* owned 49.9% of the shares of Company *B*. Another company, *C*, entered into an agreement to buy 19.5% of the *B* shares held by a subsidiary of *A* (*A*’s remaining shares of *B* were held by another subsidiary). This agreement was conditional on *C* acquiring 48% of *B*’s shares (or 28.5% beyond those covered by the agreement itself). *C* made an offer to *B*’s remaining shareholders at A\$.75/share; the shares’ market price, which had been in the A\$.80 range, jumped to A\$1.01/share. *A*, however, had an incentive to tender because the aggregate price it would receive through the negotiated transaction and acceptance of the public offer amounted to about A\$40 million or A\$1.50/share. Thus, *A* would receive considerably more value per share for its holdings of *B* than *B*’s public shareholders. The NCSC alleged before the Supreme Court of New South Wales that this combination of agreements violated CASA. The court adjourned the proceeding pending a meeting of *B*’s sharehold-

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184. Ontario Securities Commission, Policy 9.3(B)(2) & (3). Relatedly, the City Code prevents an officer and persons acting in concert from buying shares at prices higher than those in the offer without revising the offer price upward. In *Regina v. Panel on Take-Overs and Mergers*, [1987] 2 W.L.R. 699, the Court of Appeal held that the Panel’s determinations as to the composition of a concert party could be the object of judicial review.

185. See Ontario Securities Act, ONT. REV. STAT. Ch. 466, § 91(3).

186. Notice, Consensus on Amendments to Take-Over Bids/Issuer Bid Rules ¶ 3(b). Market purchases, however, are permitted, subject to an obligation to disclose them daily to the Commission and to any exchange on which the target is listed.

ers to approve the sale in which *A* and its associates were not to vote.<sup>187</sup> The central concern, under CASA as under the Ontario statute, is that related transactions not be deployed to deprive public shareholders of a full share in the benefit of sales of corporate control.

### B. Treatment of Inferior Equity Securities

The extent to which differential treatment of security holders (based on differences in their securities' voting rights) is tolerated varies greatly in each of these systems. In the United States, the protection of security holders with lesser voting rights does not seem to have surfaced as a regulatory concern in the takeover context. The situation in Canada is in marked contrast. The Ontario Securities Act permits a takeover bid to be restricted to one class of an issuer's securities and restricts the follow-up obligation to securities of that class, but no prospectus has been underwritten since 1981 that did not contain protective provisions giving holders of restricted or special voting shares the benefit of any takeover bid.<sup>188</sup> In Britain, the City Code has addressed the same problem by imposing an obligation on the acquiror to make a follow-up offer once thirty percent voting control is acquired. The City Code requires that the follow-up bid be made to "the holder of any class of equity security whether voting or non-voting. . ."<sup>189</sup> The protection afforded by the City Code, however, is only applicable once thirty percent voting control is acquired, and thus is less complete than the protection created by the conventional Canadian underwriting practice.

In Australia, protection for holders of inferior-grade equity is weaker. The stock exchange listing requirements formerly required an offeror who was bidding for all shares in a class to make an offer for shares in other classes.<sup>190</sup> CASA continues this requirement only in vitiated form, by providing that an offeror who acquires ninety percent of a company's voting shares must give notice to all holders of non-voting shares and convertible shares,<sup>191</sup> who in turn may require the offeror to purchase their securities.<sup>192</sup>

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187. This incident is described in Coleman, *supra* note 43, at 206.

188. See SECURITIES INDUSTRY COMMITTEE REPORT, *supra* note 12, at 33.

189. See CITY CODE, *supra* note 84, Rule 9.1.

190. See Gonski & Keenan, *supra* note 93, at 228.

191. CASA, *supra* note 146, at § 43(4).

192. *Id.* at § 43(6).

### C. Mandatory Buyouts—Problems in Implementation

Two of the jurisdictions surveyed in this Article, Ontario and Great Britain, require purchasers of shares to offer to buy out the corporation's remaining shareholders under some circumstances. This section of the Article develops further the differences between the buyout obligations in Britain and Ontario, focusing primarily on difficulties that have arisen in the implementation of each.

In Britain, the City Code requires a buyout offer when a person and those acting in concert with him acquire shares or rights over shares that represent thirty percent of the voting rights.<sup>193</sup> One practical difficulty with the administration of this requirement stems from the extension of the buyout obligation to persons "acting in concert" with the acquiring person. The applicability of the requirement to "concert parties" (in the British terminology) means that factual questions can easily arise concerning whether any particular associate of the acquiring person is indeed acting in concert to obtain control of a company.<sup>194</sup> It further means that the buyout obligation may ultimately apply to persons who argue that they were unaware of its applicability to them, including persons who did not themselves acquire any shares.<sup>195</sup>

A second problem arises from the Code's requirement that the mandatory offer be in cash or that it contain a cash alternative equal to the highest price paid by the offeror or its concert party over the preceding twelve months.<sup>196</sup> The Panel's ability to achieve compliance with the buyout requirement, however, has been frustrated in situations in which the acquiring person lacked the cash resources to implement its bidding

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193. CITY CODE, *supra* note 84, Rule 9.1.

194. "Acting in concert" is defined expansively in the Code to "comprise persons who, pursuant to an agreement or understanding (whether formal or informal), actively cooperate, through the acquisition by any of them of shares of a company, to obtain or consolidate control . . . of that company." *Id.* at B1. "Control" is defined to mean a holding of 30% or more of a company's voting rights, "irrespective of whether that holding or holdings gives *de facto* control." *Id.* at B3. The Code also obliges directors of the target who sell their shares to a purchaser who incurs a buyout obligation to "ensure as a condition of the sale that the purchaser undertakes to fulfill his obligations . . ." to make the mandatory offer. Except with the Panel's consent, directors should not resign from office until the offer closes or becomes unconditional as to acceptances. *Id.* Rule 9.6. Target directors who sell to a purchaser that fails to fulfill its buyout obligation nonetheless do not appear under the Code to be subject to the buyout obligation themselves.

195. *Id.* Rule 9.2.

196. *Id.* Rule 9.5.

obligation,<sup>197</sup> and persons acting in concert with the acquiror were, for one reason or another, likewise unable to make a cash bid.<sup>198</sup>

Somewhat different problems in implementation have arisen for the buyout obligation imposed by the Ontario Securities Act. A buyout offer is required by that statute if more than twenty percent of a company's voting securities are acquired in a private purchase from fourteen or fewer holders at a price more than fifteen percent above the securities' average market price for the ten business days preceding the private purchase.<sup>199</sup> The buyout offer must be for consideration "at least equal in value" to that paid in the private purchase.<sup>200</sup>

The statute's definition of the circumstances that trigger the buyout obligation creates two separate administrative problems for the OSC. First, because the statute permits the mandatory bid to offer "at least equal value," the OSC has devoted many hours of hearing time to valuation questions concerning the comparative merits of different packages of securities.<sup>201</sup> The necessity for administrative consideration of such questions is, in contrast, reduced by the City Code in Britain which requires that all mandatory offers be for cash or contain a cash alternative. Second, the buyout obligation in Ontario is triggered by the payment of a price under the private agreement that exceeds average market price by more than fifteen percent. This definition of the trigger event has led the OSC to scrutinize closely the composition of the reported market price. For example, the OSC appears to be open to the argument that the reported market price was artificially high because it had been manipulated and thus that the "true" market price was lower than the reported price and the purchaser paid a sufficiently high premium over "true market price" in the private purchase to trigger a buyout obligation.<sup>202</sup> In contrast, the City Code's buyout obligation does not employ a trigger premised on market price, so the question of credibility of market price does not arise.

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197. See A. JOHNSTON, THE CITY TAKE-OVER CODE 288 (1980) (describing situation in which purchaser lacked financial resources to make mandatory offer).

198. See *id.* at 294-95 (South African member of concert party unable to implement his obligation to make mandatory offer due to difficulties with exchange control. Panel releases him from obligation but directs him not to buy or sell shares in target or lend stock to principal purchaser, nor to frustrate any bid for target acceptable to shareholders who would have received mandatory offer).

199. Ontario Securities Act, ONT. REV. STAT. Ch. 466, § 91(1).

200. *Id.*

201. See SECURITIES INDUSTRY COMMITTEE REPORT, *supra* note 12, at 8.

202. *Id.*

The timing of the buyout offer may also create difficulties. Under the Ontario statute, the offeror has 180 days after the private purchase to make a follow-up bid. The potential lag of six months may make the follow-up bid impracticable, due to changes in the market for target shares or in the offeror's financial position. The length of the lag time may also call into question whether the target's shareholders are truly being offered equivalent consideration and whether they should be compensated for the delay by a payment of interest.<sup>203</sup> In contrast to the Ontario statute, the City Code does not contain any bright-line test for timing the follow-up bid. The offeror has an incentive to make the bid promptly because under the Code, except with the Panel's consent, no nominee of persons obliged to make a follow-up offer may be appointed to the board of the offeree company until the mandatory offer document is posted, nor may the offeror or its concert party exercise votes attaching to any share in the offeree company until the offer document is posted.<sup>204</sup>

The difficulty with the Ontario requirement that appears most vexatious legally is its potential for extraterritorial application. The Ontario statute, including the follow-up obligation, applies so long as one shareholder of the target company has an address in Ontario on the company's books, even though the target is not incorporated in Ontario and the purchase triggering the follow-up obligation takes place outside Ontario. As no other Canadian jurisdiction has chosen to impose a buyout obligation, Ontario's application of its statute to transactions in shares of companies incorporated in other provinces that are executed outside Ontario is seen, at least in some circles, as an affront to intra-Canadian comity.<sup>205</sup> Problems of this sort are inevitable, however, in federal systems with inconsistent bodies of state law where no supervening federal statute applies to the question, and no unanimously assented-to principle clearly establishes states' relative prerogatives.<sup>206</sup>

## V. THE SIGNIFICANCE OF RULES IN SHAPING TRANSACTIONAL CLIMATE

Thus far, the Article has discussed differences among takeover envi-

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203. *Id.*

204. CITY CODE, *supra* note 84, Rule 9.7.

205. See Coleman, *supra* note 43, at 210 (referring disparagingly to "sandbox theory" of OSC).

206. For a discussion of related problems in the United States context, see DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (Summer 1985); Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1.

ronments and among legal (and extra legal) rules regulating takeover transactions in four countries. Whether these two types of differences are connected is examined next. This section of the Article identifies four respects in which takeover environments seem to differ markedly and traces them, at least in part, to differences among rules governing transactions and rules determining the availability of particular types of transactions.

#### A. *Hostile Bidders' Success and Failure*

The success of hostile bidders in acquiring control of targets seems to vary among jurisdictions. For example, as Section II illustrates, the "failure rate" of bidders appears to be higher in the United States than in Britain. Some of this divergence can be explained by differences among the rules defining the transactional environment in which the bid is made. In the United States, target managements are more free than in Britain to participate aggressively in takeover contests, and, in particular, they are able to ease the entrance of friendly bidders into the contest, subject to the constraints of fiduciary duty. Indeed, in the United States target managers are free to participate in bidding groups proposing to buy out the company's stockholders and finance operations principally through debt. But company law in Britain and Australia limits the defensive use of leveraged buyout transactions.<sup>207</sup> Further, the Williams Act in the United States may, on balance, encourage more bidding contests than would otherwise occur by granting target shareholders additional rights to withdraw tendered shares when a competing bid is made. Thus, the basic legal framework in the United States may make contested bids more likely. Although this likelihood does not mean that more targets will ultimately remain independent, it does reduce the initial hostile bidder's chance for success. Correspondingly, however, the likelihood of contested bids may also increase the premium received on average by target shareholders. To be sure, factors other than the rules applicable to takeover transactions also affect whether competing bids will be made. These factors include the number of prospective bidders who are active in any given market and their ability to obtain financing for takeover transactions.

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207. See *supra* text accompanying notes 161-62.

### B. Partial Bids

Another difference among the transactional climates discussed in this Article that can be partly attributed to differences among rules is the prevalence of partial bids in one country (Australia) and their striking paucity in another (Britain). As noted above,<sup>208</sup> the City Code in Britain has rules that make partial bids unattractive. Further, the Code requires consent of the Take-Over Panel for such bids. None of the other jurisdictions regulates partial bids so exactingly as to discourage them. This fact explains the relative infrequency with which such bids are made in Britain.

The relative popularity of such bids in Australia is more resistant to explanation in terms of divergent rules, for the rules applicable to partial bids in the United States are not so different from those in Australia as to explain why many more bids in Australia are partial offers. One possible explanation is simply the demographic differences between the two countries. Australia, despite its vast land mass, has less than one-tenth the population of the United States<sup>209</sup> and, correspondingly, much smaller financial markets. Australia also has a few individuals who, through complex holding company structures, own controlling interests in hundreds of Australian companies but do not necessarily own all the shares of those companies.<sup>210</sup> In short, the prevalence of the partial bid in Australia may be explained by the activity of a relatively small number of

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208. See *supra* text accompanying notes 92-93.

209. The current population of Australia is reported to be 15,543,600. 1986 INFORMATION PLEASE ALMANAC 151.

210. For example, the defendant in N.C.S.C. v. Industrial Equity Ltd. is reported to have direct or indirect control over "some hundreds" of companies. After obtaining a substantial interest in a target through a subsidiary, it negotiates for a seat on the board of directors to gain information so that it may determine whether a takeover bid for more shares would be advisable. *See* (1982) A.C.L.C. 35, 38 (Sup. Ct. N.S.W. 1981). The New Zealand Securities Commission, in a review of the law and practice concerning corporate takeovers, studied a takeover bid for Bing Harris & Co. Limited made by Brierly Investments Limited. Brierly Investments is an eponymous corporate vehicle of Ronald A. Brierly, who also as it happens is the chairman of Industrial Equity Limited. Following the purchase of 20% of Bing Harris's shares by Brierly Investments, a Brierly nominee was appointed to the Bing Harris board, and subsequently in his capacity as a director became intimately familiar with its affairs. Two years after the nominee director's appointment, Brierly Investments announced its intention to make a takeover bid for Bing Harris, and to make it prior to the scheduled directors' meeting at which Bing Harris's half-year financial results would be considered. These results were, however, known to the bidder at the time it announced the bid, which was well in advance of any public disclosure. During the four months preceding its announcement of the bid, Brierly Investments purchased additional Bing Harris shares, raising its ownership to 33%. *See* Securities Commission, 2 Company Takeovers: A Review of the Law and Practice 3-7 (1983).

This sequence of events calls into question, among other things, the propriety of a substantial

active bidders who seek to diversify their holding companies' "portfolios" by making partial bids for more targets rather than any-and-all share bids for fewer targets.

### C. Defensive Transactions

The jurisdictions discussed in this Article also differ significantly in the role that can be played by target management in contesting a hostile takeover bid. In the United States and Canada, fewer constraints are placed on management by the rules specifically regulating takeovers. In both systems, the propriety of management's action is tested by fiduciary standards, and considerable leeway is available to management. Although recent cases have reduced management's prerogatives under some circumstances in the United States, in both countries the cases regard management as properly playing an aggressive defensive role on behalf of the target and its shareholders, and in both countries many types of defensive transactions are available towards that end.

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shareholder's access to and use of non-public information, received through the conduit of its nominee director. The Securities Commission concluded that

it is improper for a shareholder, who has obtained from a director of a company information about the company's affairs that is relevant to the market price of securities issued by the company, to buy or sell such securities while the market does not have access to that information. Moreover, a director acts improperly who passes such information with knowledge that the recipient is buying or selling, or intends to buy or sell, the securities.

*Id.* at 28. It is noteworthy that New Zealand has no statutory treatment of insider dealings in shares. Its Court of Appeal has, however, recognized circumstances in which trading on the basis of non-public information may be a breach of fiduciary duty. *See Coleman v. Myers*, [1977] 2 N.Z. L.R. 298.

In Australia, § 229(3) of the Companies Code prohibits present or former corporate officers, directors and employees from making "improper use" of information acquired by virtue of their positions with the company to gain an advantage for themselves or for any other person or to cause detriment to the company. Further, § 128 of the Securities Industry Code prohibits dealings in the securities of a corporation on the basis of information that is not generally available, by persons "connected" to the corporation in such a way as to put them in possession of such information. A person is "connected" to the corporation for these purposes if he 1) is an officer or director of the corporation, or 2) is a substantial shareholder (within the Companies Code definition) of the corporation, or 3) occupies a position giving access to non-public information as a result of a professional or business relationship with the corporation or service as an officer of a substantial shareholder. *Id.* § 128(8). A "substantial shareholder" of a corporation under § 136 of the Companies Code is a person who is entitled to vote 10% of any class of the corporation's voting shares. The prohibition on share dealings on the basis of non-public information would thus appear to reach a "substantial shareholder," once voting rights as to 10% of a corporation's shares have been acquired, because the person is then "connected" to the corporation for purposes of § 128. Many questions remain, however. Does "dealing in securities" encompass making a takeover bid? And is the nominee director making "improper use" of the non-public information merely by transmitting it to someone who may trade on it or may make a takeover bid for the company?

Management's defensive role is more modest in Britain and Australia. In Britain, the City Code requires that shareholders vote to approve defensive transactions when a takeover bid is outstanding or when such a bid appears to be likely. Target management may, however, attempt to persuade shareholders not to tender and may attempt to lay defensive fortifications in advance of a bid. Target management is similarly constrained in Australia by organic company law and by judicial interpretations of managers' fiduciary obligations. CASA requires target shareholder approval for defensive share allotments of twenty percent more. Further, the defensive buy out transaction is not available in Australia.<sup>211</sup> Finally, in both countries the basic norm of company law that directors are removable without cause by majority vote of the shareholders further limits target management's defensive options.

#### *D. Post-Bid Transactions*

The jurisdictions' rules also differ in the limits placed on transactions in the wake of a successful takeover bid. In Britain, and under some circumstances in Ontario, once a defined threshold of share ownership is attained, the person acquiring those shares must offer to buy out the other shareholders on comparable terms. Thus, acquiring effective control under these rules entails an obligation to offer to buy all shares, thereby increasing the cost of acquiring effective control. In contrast, in the United States and Australia, an offeror who obtains effective control is under no obligation to offer to buy out the remaining shareholders. Indeed, the United States permits a cash bid for a legal majority of the target's shares to be followed by a merger transaction in which the remaining shareholders receive different (non-cash) consideration, subject only to an appraisal remedy provided by state law. On the other hand, nothing in the United States would prohibit a corporation's shareholders and directors from adopting charter amendments to require equal treatment of shareholders in the event of a shift in effective control.

## VI. CONCLUSION

The comparative analysis of institutions and legal rules in this Article illustrates two basic points about corporate takeovers: first, whether hostile takeovers occur in any system depends on patterns of share ownership, control and voting. These can readily be manipulated to preclude

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211. See *supra* Section III.D.

hostile bids. Second, the countries in which hostile bids occur with frequency differ greatly in the constraints imposed on bidders and on managements of target firms. Indeed, takeover regulation in each of these countries seems to strike a different balance between the strategic positions of hostile bidders and target management. The United States regulates bidders with a markedly lighter hand than do the other three countries. Bidders are not required to make a general all-holders bid if any particular level of share ownership is sought, nor are they required to make follow-up offers to non-controlling shareholders after a trigger point of share ownership is passed. Partial bids are not especially discouraged by regulation, and bidders may freely condition their offers. Under these rules, a person may acquire effective control of a corporation without being put to the cost of acquiring non-controlling shares at a price equivalent to that paid for the shares conferring control. But target management enjoys considerable strategic flexibility as well. Organic corporate law in the United States does not preclude such transactions as defensive share repurchases, selective issuer tender offers and leveraged management buyouts. The protective reach of the "business judgment" approach is still extensive, although some recent cases have declined to indulge defensive lock-up transactions in which target management's preference for one bidder over another is vulnerable to attack as self-interested or insufficiently considered.<sup>212</sup>

In Britain, the rules of the Take-Over Panel make acquisition of effective control a more expensive proposition for the acquiring party, who must offer to buy out the target's remaining shareholders once the thirty percent threshold is passed. Partial bids are specifically discouraged, especially those that would give the bidder effective control of the target. The bidder's ability to condition the bid is limited by regulation. Target management, on the other hand, is significantly more inhibited than in the United States in its ability to defend aggressively against hostile bids. The City Code requires target shareholders' approval for defensive measures that could terminate the bid, and statutory company law limits the target's ability to use defensive share repurchases and lend financial assistance to preferred bidding groups. The City Code's restrictions on

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212. Even in the absence of a lock-up, a management-sponsored transaction may be vulnerable if it is structured to give shareholders no effective choice between it and a contending third-party offer. See *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 113-14 (Del. Ch. 1986) (applying *Unocal* test, court enjoined coercive issuer tender offer purportedly adopted to give shareholders an alternative to third-party offer).

target management are consistent with judicial interpretations in Britain of management's fiduciary duties. These interpretations historically have recognized in shareholders a right, external to the directors' powers over the company, to assemble majority positions.

Target managers in Canada are in a position quite close to that of their counterparts south of the United States border. Organic corporate law enables managers to deploy a wide range of defensive transactions, while their use is tested by a standard that gives primacy to the directors' business motivations. The use of defensive share issuances, however, appears to be more inhibited in Canada due to the TSE's reservation of power to consider whether any such transaction should be tested by a plebiscite of the issuing company's shareholders. The costs associated with acquiring control of a Canadian company vary depending on the provincial regulation applicable to the transaction. Under the Ontario statute, acquisitions over a twenty percent threshold must be made through an all-holders bid, and exempt private acquisitions of twenty percent blocks must be followed by an offer to buy out the other shareholders. Although partial bids are permitted, the bidder's ability to condition any offer is limited to types of conditions specified in the statute.

In Australia, bidders may make partial offers but as in Ontario, acquisitions over a twenty percent threshold must be structured through an all-holders bid. The offeror's use of conditioning language in its bid is regulated by statute only if it seeks to make on-market purchases during the offer, in contrast to the regulation of conditions in Ontario and Britain. On the other hand, target management appears to have fewer defensive resources available to it than in the other three systems. Although the judicial response to defensive transactions appears to have mellowed in recent years, organic company law prohibits share repurchases and subjects the lending of financial assistance for the purchase of a company's shares to a shareholder plebiscite.

Is one of these systems clearly preferable from the standpoint of shareholders' interests generally? On this point it is helpful to keep in mind that the two systems that make the acquisition of control most costly for the acquiring person, Britain and Ontario, like the other systems have seen high levels of acquisition activity in recent years. This makes problematic the argument that shareholders as a group are invariably better off with rules that, by permitting bidders to minimize their costs, encourage more rather than fewer bids. The consequences of target management's differing role in these systems is difficult to assess. One

possibility, suggested by the United States and Canada, is that management's more aggressive defense leads, in many instances, to higher premiums to target shareholders, if management can ease the path of bidders willing to offer more. But this is not the outcome in all instances. In many instances management's motivations seem sufficiently in doubt that a closer regulation of management's defensive capabilities is attractive.

