Boards' Governance of Hostile Takeovers in the US and the UK

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Abstract. It is argued heatedly whether the governance of the board in a company against hostile takeovers is of necessity in the United States and in the United Kingdoms. This study aims to determine whether this intervention of boards should be legitimatized according to laws in these two countries in order to gain a better legal environment for the market. Literature research method had been used in this paper and conclusions were analyzed to reach the aim. The result in this study suggests that the effects of hostile takeovers on corporate governance are quite different owning to the different jurisdiction in the United States and in the United Kingdoms. Obvious as it is, corporate governance changes according to local legislations. The United States tends to have a more tolerate jurisdiction on whether the management of corporate should be entitled to intervene or block hostile takeovers. The United Kingdoms, on the contrary, tends to be more disciplined in administration for the board in a company issued on this type of governance.

Keywords: Hostile takeover; corporate governance; corporate legislation; merger & acquisition.

1. Introduction

In recent years, with the rapid development of mergers and acquisitions, hostile takeovers appeared and has to a great extend influenced the mergers and acquisitions in its own way. However, this particular type of takeovers has always been for controversy, for its different governance in the U.S. and in the U.K. The hostile takeover in terminology is that a bidder offeror, who goes beyond the management of the target company, makes an offer directly to the target shareholders to acquire their shares in order to have control of the target company. Hostile takeovers are without doubt occurring in mergers and acquisitions and playing an important part in both positive and negative perspectives. In a hostile takeover, a bidder perceives that the target corporation's value under incumbent management is less than it could be in the bidder's hands [1]. According to the definition, this type of mergers is usually considered hostile to the management of the target company, for its avoidance of the management in a company. Understanding the definition of hostile takeovers and how the two countries react towards hostile takeovers drives to this study. Current dominant methods are literature research, empirical analysis, and case analysis. In this study, it was to mainly discuss two different types of doctrines in the United States and in the United Kingdoms. Simultaneously, this paper focused on how these two different types of law systems effect on hostile takeovers. Furthermore, issues like cross-border transactions which lead to different rights of jurisdiction or competency in these two countries were researched. And ultimately approached to the conclusions by applying the literature research method. The result in this study is pro company boards to have the right within legal practice to block hostile takeovers.

2. Review

2.1 Literature on Hostile Takeovers in the U.K.

In the UK, hostile takeovers occurred in 1950s and it developed so rapidly that it has drawn great attention in law and finance. The UK tried to prohibit such hostile takeovers by establishing new mergers and acquisition code to replace the *Statute of Frauds*. The Takeover Panel--which includes representatives from the securities market, the Bank of the Great Britain, the key merchandiser banks, and institutional investors--administers a group of rules referred to as the *City Code on Takeovers and Mergers* [2]. Its practice on regulating the mergers and acquisitions is entirely dependent on the careful and meticulous work of the Takeover Panel and the close cooperation of the members of the organization.

There have been some actions issued on it. The defensive mechanisms in the United Kingdoms are in general based on *City Code* mentioned above. The traditional UK approach is not to allow boards to 'frustrate' takeovers. It is thought that a takeover offer is only between the bidder and the target shareholders, and that the board should not interfere [3]. *The Company Act 2006* clearly emphasizes on impropriety of purposes and intentionality, which means that the boards shall not act in any way to restrict the rights of shareholders. And that is the 'No Frustration Rule' for hostile takeovers in UK. *The Company Act* also stipulated that director may exercise a power of the company to allots share in the company, or grant right to subscribe for or to convert any security into shares in the company. The original shareholders have the right to subscribe in proportion to their shares as well. And there is the 'Sell Out Rule', which stands a compulsory purchase if the offer in a takeover transaction is accepted by 90% of the shareholders. In fact, the U.K. has bound blessings over the U.S. in that there are fewer antitakeover provisions enshrined in either company charters or state legislation, as an example, the *Takeover Code* within the Great Britain expressly prevents the appliance of poison pills once a takeover purchase has been launched [4].

2.2 Literature on Hostile Takeovers in the U.S.

As it is well-acquainted almost to the whole world that in the 1980s, America had the stagflation, known as the stagnation and the inflation. The weakness of the real economy was directly reflected in the stock market. As a result of the downturn in the stock market, many blue-chip stocks were vastly undervalued, and mergers and acquisitions had become considerably profitable. This result had intrigued a flurry of hostile takeovers.

In practice, a hostile takeover of a company usually results in reorganization of the top management, change of the company's approach, and layoffs. To cope with this type of takeover, the anti-takeover legislation in the US began with the *Clayton Anti-Trust Ac*t passed by the United States Congress. Its legislative idea lies in "monopoly is evil". The acquisition legislation at the federal level of the United States was derived from *the Williams Act* [5]. The act aims to protect the interests of investors through a full and fair disclosure system to achieve the same protection for the management of the target company and the acquirer. As a proportion of total M&A equal-weighed volume, hostile activity peaked now before the proportion of the Williams Act in 1967 at forty percent and has since declined to concerning five percent in 2013. Though hostile activity is a smaller amount common than it once was, it's under no circumstances disappeared [6]. These legislations have ensured that the boards in US can apply multiple defensive mechanisms against hostile takeovers. And in reality, companies worldwide prefer to establish in Delaware State, for it having an advanced and systematic legislation in relevant aspects. There had been tons of mergers and acquisitions in American history, and it is these countless trials that improve the atmosphere of market and corresponding legal system.

2.3 Current Principles and Duties in Hostile Takeovers

There are some principles or duties that will be useful for the court or the board of company itself to apply or follow. Revlon Principle was established in the case *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*. The emergence of Revlon Principle was a milestone for company governance. It rules out that when the sale or the split has reached to an inevitable stage, the duty of board shift to strive for the maximum benefits of the company. The Revlon Principle's aim eventually is to protect the interests of all shareholders and discipline the reaction of management in a transaction. By having this rule with actual judicial effect, boards in a company can better perform their duty of loyalty and care, which should not just be constraints and obligations that do not exist only by self-awareness. It also highlights the specific positions and responsibilities of the board of directors. And the Unocal Principle was established in the case *Unocal Corp. v. Mesa Petroleum Co*. This case has had a profound influence for judicial causes even in the current system. The Unocal Principle is usually used to determine whether the defense is legal. Two points are of importance: enough reasons and fairness for all shareholders. It simply means that to define whether a takeover is hostile or friendly in civil court, the party with burden of proof and its AD litem need to provide evidence to prove the acquisition has reasonable causes and it is fair for all shareholders in the company. Otherwise, this acquisition shall be considered hostile by the Unocal Principle and the legitimate anti-takeover measurements can be immediately performed in the United States. Under the Unocal standard, the board may preclude hostile offers without demonstrating that maintaining the independence of the target company is a more valuable course than accepting the bid [7]. This principle should invoke Business Judgement Rule and is protected by it. The Business Judgement Rule is, if a director of a company makes a business judgement and decision in good faith, fulfills the duty of care, and obtains reasonable information basis, then the director can be exempted from legal liability even if the decision is wrong. All principles above identify the positive role of the board of the directors and urge the board to comply with the duty of care and the duty of loyalty.

3. The Position of Boards in Anti-hostile Takeovers

3.1 Comments on the Current Legislation in the U.K. and the U.S.

After all these literature research, comparison between the UK and the US can be analyzed. The attitude towards the target company in the US is more of pro the anti-takeover measures. They encourage management to react accordingly. Several legislations and acts illustrate that they prefer to create a rather fair atmosphere for the boards in a company and hold opinion against monopoly. And in the UK, it's more traditional and conservative, they have many restrictions established in law towards anti-takeover reactions, for their concerns about the interests of the whole shareholders than just the boards in a company. And that difference might just exist because the United States think the boards are to decide and on the contrary the UK sustain the shareholders are those in a company to decide. It is never right or wrong of their views and correspondent legislations, for their different perspectives on this issue are from different aspects and stances. Also intriguingly, the boards in the US are expected to act to satisfy the maximization of interest. Because by having authorized the right to use defensive strategies or to frustrate the hostile takeovers can the target company bargain for more. And in the UK, the boards shall stay neutral. They must obey the 'No Frustration Rule' because their intervention might be out of personal interest and eventually damage the interest of some shareholders. Those are different provisions for management obligations.

According to the preceding findings in this study, the board in a company should be entitled to block hostile takeovers. Here are some reasons.

To start with, the boards can help the company to pursue a higher price in a transaction using legal techniques and strategies. Furthermore, that attitude literally sustains the role of board management should be positive thus helpful in any aspect or during any period of its own company. Secondly, by authorizing the power to block hostile takeovers, the lawyers and economics can participate in these transactions and play a part within their own field and create more genres in these specific field. Their professional advice assists the company and even the market develop better and be more reasonable, for holding the belief that more participation from different aspects gains more positive improvements. Meanwhile, the provisions of blocking hostile takeovers actually prompt the boards to be more diligent, careful, and loyal in operating a company. Without the permission of anti-takeover actions, they might have been just less caring and more ignorant, which is unethical in profession and fails to perform their duties as board members. Evidence is found that bidders in hostile takeovers are superior performers in terms of profitability, compared to either non-merging firms or bidders in friendly takeovers [8]. To end with, the empowerment of the boards in the United States to block hostile takeovers shows the best interest of the target company can be assured.

3.2 The Function of Boards in Anti-hostile Takeovers

There have been a lot of strategical moves for a board to legally call off a hostile takeover. Many innovations in the art of hostile takeover defense were encouraged by the high level of hostile activity during the 1980s. Because of the incremental application of fiscal resources by companies that are menaced, defensive mechanisms grew quite luxuriant and more complicated to filter [9]. Due to the research and change of successive financial experts and jurists, many anti-hostile takeover strategies have been adopted in various countries and amongst all, they prosper the most in the United States. In general, there are four main approaches. First is to raise acquisition costs for acquirers. The company will rent a finance expert for associate plus appraisal as a result of the accounting in current era, assets area unit is sometimes valued at historical worth. With normal inflation, historical prices area unit is usually not up to the important price of assets. Since there is an intrinsic connection between the acquisition bid and the book value, increasing the book value will increase the acquisition bid and inhibit the acquisition motivation. Management Buyout, known as the MBO, has two forms to practice. One is to distribute the cash that would be available to the shareholders, which is for the senior management choose not to pay dividends, but to use a different way as in buying the shares back. The other is stock market, that is, the provision of company bonds, special shares, or their combination to recover stocks, by reducing the quantity of shares in circulation, raise the stock value, forcing the acquisition to boost the purchase value of every share. White Knight strategy is apparent as its name. The target company can find a friendly bidder as its "White Knight" instead of being threatened by a hostile bidder. This act can be applied to increase the price by including a third friendly party in the bidding competition. Thinking from a different aspect, the target company can apply the Golden Parachute, a compensation agreement. When the company is purchased by the bidder, management of the target company is at high risk of replacement, and the Golden Parachute provides that in the event of a takeover of a target company, senior management, either voluntarily or forced to leave the company, can receive a large resettlement payment. Likewise, there is Silver Parachute for junior management. The second approach is to reduce the acquirer's acquisition income or increase the acquirer's risk. The business world likes to refer to its best-run and most valuable business or subsidiary as a jewel. It is usually the "jewel" that prompts the desire of the bidder company for an acquisition. And the Crown Jewel defense is for the target company to sell its "jewel" to back off the bidder and ultimately protect its other property. This defense is of much similarity to the Scorched Earth Tactics, or is included by it. The Poison Pills strategy is used by the target company's board, who previously or afterwards act in a takeover. This strategy can guarantee the shareholders in the target company purchase shares at a great discount to dilute shares of the bidder and increase the cost of acquisitions. Another type of Poison Pills is that the majority of the company's senior management have jointly signed an agreement to resign en masse in the event that the company is acquired at an unfair price and one of these individuals is demoted or removed after the acquisition. So, this strategy can actually make the hostile takeover beneficial for the target company if the boards comply with the fiduciary duty. The third way is easy to comprehend, which is to acquire the original acquirer, also known as the Pac-man Defense. Lastly, amend the articles of association in due course. This is a precaution companies take against potential acquirers or fraudsters. The implementation of anti-takeover clauses, the direct or indirect increase of acquisition costs, and the provisions of board reelection can make the acquirer recoil. Common anti-takeover articles of association include: round election of the board of directors, super majority clause, fair price clause, etc.

3.3 The Objective Aspects of Hostile Takeovers in the U.K. and in the U.S.

The analysis shows that it is indeed different governance towards anti-takeover actions in UK and in US. The UK's approach is narrower and more conservative. The US's way of addressing the hostile takeovers is more multiple and open. Might or not it's that, instead of deterring bidders altogether, the employment of defensive measures within the U.S. has merely resulted in an amendment of techniques. As a result of a target board's consent, it's important to have an effect on a takeover wherever a good defense is in place, U.S. acquirers' area is without doubt currently entering into negotiations with the target's board than to create a "hostile" supply on to shareholders [10].

The boards should be allowed to block hostile takeovers. Which is, to strengthen the idea that hostile takeovers should be under corporate governance. Anyhow, the findings above are subject to several limitations. First, this research is unclear to what extent the results can be generalized to other governance and legislations. Each policy's implement should consider various influence factors. This external limitation exists when the region or legislature changes. Second, no matter how well the boards perform in a hostile takeover, personal issues and defaults effect transactions and judgements. Lastly, the opinion and hypothesis in this study, which is pro the boards to block hostile takeovers, based mostly on the idealism of the boards operating with full duties aware and practicing with diligence and ethic.

The future of governance and legislations in mergers and acquisitions is promising. With decades of development and improvement in this area, certainty is ensured that future policy against hostile takeovers will be more united and thorough. Two possibilities can be brought up in the future research. How can the global market to integrate different governance and legislations of the boards worldwide? And how can the government or the legislature ensure that directors create maximum value for the company and strictly comply with their obligations? This study, however, is left for future research.

4. Conclusion

The aim of the present research was to illustrate those different patterns in US and in UK towards hostile takeovers. Main conclusions can be drawn from this work, as follows, first, this study supports the idea that the United States' focus on board independence better protects targeted companies than the UK's reliance on the 'No Frustration Rule'. Second, tactics and defense strategies can be and should be taken within legal practice when confronting a hostile takeover. Third, the hostile takeovers can never be defined or addressed by one single part. It is the joint effort and governance that maintain the important position of hostile takeover in domestic and international trade. Last but not least, the improvement of hostile takeovers' environment requires future implement of legislation and regulation, which is likewise a natural and necessary development. This study was conducted by reviewing the background, history, defense, legislation, and strategy to reach the analysis in comparison. Opinions and literature research of hostile takeovers were provided in main purpose to improve the development of hostile takeovers in mergers and acquisitions, in both financial and legal way.

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