EDITORIAL

Takeover Bids by Controlling Shareholders

Takeovers are one category of control transactions, where a bidder makes a general and public offer to the shareholders of the target company. Takeovers give rise to agency conflicts and coordination problems, which takeover regulation seeks to address.[1] These agency and coordination issues are exaggerated when the takeover bid is launched by a controlling shareholder or bidder, who teams up with a key shareholder forming a consortium. Agency conflicts arise between the controlling shareholder and minority shareholders. Minority shareholders are pressurized to tender their shares out of fears that the controller will expropriate them. For instance, the controlling shareholder may announce its intention to delist the company following the successful completion of the bid leading minority shareholders to tender their shares in order to avoid the loss of liquidity associated with a delisting. What is more, information asymmetry between non-controlling shareholders and controllers, which are privy to inside information regarding the company's current business and prospects, features prominently. Controllers may opportunistically time their bid in order to take over the company at a discounted price. Having full control over the timing of the offer, a controlling shareholder exploiting non-public information available only to him can choose to make the offer at a time when the market is undervaluing the company.[2] Moreover, controlling shareholders will have a decisive influence on the company's board and management controlling thus the flow of information to shareholders and gatekeepers, such as investment banks providing fairness opinions regarding the bid price offered. In particular, conflicted boards will seek to downplay financial forecasts of the target and avoid disclosure of soft information regarding the target's prospects to the fairness opinion provider, in order to justify a lowball bid.[3] Finally, competing bids are not possible leaving minority shareholders without an option but to tender their shares to the controller who is in control of the process.[4] The tender premium offered on top of the listed share price will rarely compensate the minority shareholders. More specifically, controlling shareholders acting on their informational and timing advantage can time the bid so that the bid price will be higher than the listed share price but significantly lower than the company's fundamental value and even lower than a bidder would offer in an arms-length transaction.

Different jurisdictions have provided different solutions to the dangers posed by this type of transactions. In the UK, the UK Takeover Code also applies to takeovers which have as their objective or potential effect consolidating control of the relevant companies.[5] Recognizing the potential for conflict of interest and the information asymmetry between controlling and non-controlling shareholders, the Code places significant importance on the provision of competent independent advice regarding the financial terms of the offer to the board of the offeree company.[6] The independence of the adviser must be beyond question and the substance of such advice must be disclosed to the shareholders. Moreover, the UK Companies Act 2006 provides for a post-bid squeeze out right allowing a bidder to obtain full control of the target.[7] The squeeze-out right is triggered at a high percentage of acceptances with the controller having to acquire at least 90% in value of the shares to which

1 *See* generally Paul Davies et al., *Control Transactions, in the Anatomy of Corporate Law: A Comparative and Functional Approach* 205–242 (Reinier Kraakman et al. eds, Oxford University Press 3d edition 2017).
2 Paul Davies, *The Transactional Scope of Takeover Law in Comparative Perspective*, ECGI Law Working Paper No. 313 (2016).
3 Conflicts of interest that board may face include promises of lucrative post-bid employment with the acquirer, situations where board members are already economically invested in the bidder or management buyouts where board members and management are part of the bidder consortium.
4 Tom Vos, *Baby It's Cold outside – A Comparative and Economic Analysis of Freeze-Outs of Minority Shareholders*, 15(1) Eur. Company & Fin. L. Rev. 148, 157 (2018), doi: 10.1515/ecfr-2018-0006.
5 Panel on Takeovers and Mergers, The Takeover Code (11th ed., 2013), Introduction, §3(b) (UK).
6 Rule 3.1 & Notes on Rule 3.1(1), Takeover Code, at D23.
7 Section 979, Companies Act 2006.

'Takeover Bids by Controlling Shareholders'. *European Company Law Journal* 21, no. 5 (2024): 92–94.

the offer relates, and in a case where the shares to which the offer relates are voting shares, not less than 90% of the voting rights carried by those shares.[8] This majority of minority condition serves as protection against opportunistic tender offers by controlling shareholders. In particular, the more shares a controller holds before launching the offer the more difficult it is for it to reach the 90% acceptance level.

The EU Takeover Directive is applicable to takeover bids defined as a public offer made to the holders of the securities of a company to acquire all or some of those securities, whether mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company. Consolidating offers come within the ambit of the Directive only when they follow the acquisition of control, i.e., the mandatory bid rule. The mandatory bid rule obliges a person which obtains control of a company to launch, at the earliest opportunity, a bid to all the holders for all their securities. Moreover, Article 15 introduces a post-bid squeeze out right. The offeror is able to require all the holders of the remaining securities to sell it those securities at a fair price. The right is triggered where the offeror following a takeover bid holds securities representing not less than 90% of the capital carrying voting rights and 90% of the voting rights in the offeree company or following acceptance of the bid, he/she has acquired or has firmly contracted to acquire securities representing not less than 90% of the offeree company's capital carrying voting rights and 90% of the voting rights comprised in the bid.[9] Numerous EU Member States provide for squeeze out procedures in situations falling outside the ambit of the Takeover Directive, such as takeover offers from a controlling shareholder which has acquired its shareholding through a takeover in the past or where the controller is the founder of the corporation and kept its controlling stake while listing the company on the stock exchange.[10]

A major drawback of squeeze-out procedures is that they do not protect shareholders against a bid by a controlling shareholder at a discounted price. Squeeze-out regulations typically provide that the squeeze out price is presumed to be fair if it matches the price in the bid even if the squeeze-out takes place many months after the launch of the bid.[11] Member States allow dissenting shareholders to challenge the squeeze-out price before courts, which are tasked with calculating the fair value of the shares.[12] Nevertheless, significant problems arise with regards to the valuation of the shares and the choice between different valuation methods. Most notably, in case of listed companies courts in numerous jurisdictions tend to rely heavily on the share price in order to determine fair value. However, in many cases the share price is not a reliable indicator for fair value. For instance, the controlling shareholder will be privy to inside information regarding the target's business and prospects, which will not be reflected in the share price. In addition, following the launch of the bid and until the squeeze out the share price is dominated by and anchored at the bid price, which the squeeze-out price will typically match, whilst being detached from the rest of the market. Hence, the share price of the target remains frequently unchanged at the bid price for many months after the launch of the bid unaffected by market, industry or company specific developments. Consequently, this artificial share price is not a reflection of its fair value.

Delaware law in the US provides the highest standards of minority protection when it comes to freezeouts by controlling shareholders. Freezeouts in Delaware are effected either via a statutory merger or a tender offer followed by a short-form merger. The statutory merger is executed under section 251 of the Delaware General Corporation Law with cash as the merger consideration.[13] The approval of the simple majority of shareholders is required. In a tender offer structure, the controlling shareholder makes a tender offer to the minority shareholders and completed a short-form merger if the controller manages to acquire more than 90% of the outstanding shares.[14] The conflicts of interest generated by freezeouts executed by controlling shareholders have led Delaware courts to scrutinize these types of transactions under the exacting entire fairness standard of judicial review.[15] The defendant, namely the controlling shareholder, must prove that the transaction was fair to the corporation with

8 The 90% threshold only relates to shares freely accepting the bid either through acceptance of the tender or via irrevocables provided to the bidder. Purchases outside the offer are not counted in the 90% threshold. Moreover, if during the period when the takeover offer is open, the offeror acquires or unconditionally acquires any of the shares to which the offer relates but does not do so by virtue of acceptances of the offer, then these purchases are only included in the 90% threshold if the value of the consideration for which the shares are acquired does not exceed the value of the consideration specified in the terms of the offer. Section 979(8)&(10), Companies Act 2006.

9 Article 15(1) of the Takeover Directive states that the right of squeeze-out is triggered following a bid made to all the holders of the target company's securities for all their securities. As a result, purchases outside the offer, i.e., after the closing of the takeover offer and before the squeeze-out, are not counted towards the Directive's 90% threshold.

10 For instance, Germany, apart from a squeeze-out procedure applicable in case of takeover offers, has also introduced a procedure where the squeeze-out does not have to follow a previous takeover offer. *See* generally Ettore Croci et al., *The Corporate Governance Endgame – An Economic Analysis of Minority Squeeze-Out Regulation in Germany* (10 Jun. 2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2080745.

11 *See* for instance Art. 15 of the Takeover Directive, which provides that in a voluntary bid the bid price shall be presumed to be fair where, through acceptance of the bid, the offeror has acquired securities representing not less than 90% of the capital carrying voting rights comprised in the b*id.* Moreover, in case of a mandatory bid, the price offered in the mandatory bud shall presumed to be fair.

12 *See* for instance regulation 27 of the Irish Takeover Regulations, which allows a dissenting shareholder to challenge the squeeze-out terms before the High Court. Similarly, Germany allows shareholders to challenge the squeeze-out price before courts. *See* generally Andreas Engert, *How (Not) to Administer a Liability Rule – the German Appraisal Procedure for Corporate Restructurings*, FUELS Working Paper 6 (2020).

13 Section 251 Delaware General Corporation Law.

14 Short-form mergers can be executed by a simple board resolution of the target company without requiring the approval of shareholders. *See* s. 253 Delaware General Corporation Law.

15 The seminal case is Weinberg *v.* UOP, Inc. 457 A.2d 701 (Del. 1983).

fairness encompassing two elements, fair price and fair dealing. Fair dealing relates to the process of the transaction, namely the timing, structuring, negotiation of the transaction and the approvals of the board and stockholders.[16] Fair price 'relates to the economic and financial considerations of the proposal mergers, including all relevant factors'.[17] In *Kahn v. Lynch Communications*, the court held that if the transaction has been approved by a disinterested board or an independent special committee or has been approved by a majority of the minority, the burden is shifted to the shareholders challenging the transaction.[18] In 2014, the Delaware Supreme Court in the landmark *Kahn v. M&F Worldwide Corp.* decided that the transaction will be reviewed under the deferential business judgment rule if the transaction is conditioned on approval by an independent special committee, which will negotiate with the controlling shareholders and by a majority of the minority shares.[19] The vote of the majority of the minority must be full-informed and uncoerced.

Overall, the combination of an independent committee and a majority of the minority approval condition are effective safeguards against opportunism by controlling shareholders. An additional minority shareholder protection mechanism against bids by controllers at discounted prices is the appointment of an independent expert who will evaluate the target company and will be able to obtain the correct company information about the financial forecasts of the target. A simple fairness opinion falls short of that protective mechanism since the fairness opinion provider typically relies on the financial information provided by the target board, which is controlled by the majority shareholder. For instance, the UK Takeover Code stresses the importance of independent advice regarding the financial terms of the offer. In order to guarantee its independence from the controlling shareholder, the expert should be appointed by a court or other competent authority.

Alexandros Seretakis,
(LL.M. NYU, Attorney at Law, New York State),
Assistant Professor of Law and Fellow, Trinity College Dublin.

16 *Ibid.*, at 711.
17 *Ibid.*
18 Kahn *v.* Lynch Communications, 638 A.2d 1110 (Del. 1994).
19 Kahn *v.* M & F Worldwide Corp., 88 A.3d 635 (Del. 2014). Under the business judgment rule the court will not second-guess the court's decision 'unless the directors are interested or lack independence[,] ... do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process'. Brehm *v.* Eisner (Disney II), 746 A.2d 244, 264 n. 66 (Del. 2000).