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SOUR CHOCOLATE: THE U.K. TAKEOVER PANEL'S IMPROPER REACTION TO KRAFT'S ACQUISITION OF CADBURY

*Michael R. Patrone**

Abstract

This article critiques the U.K. Takeover Panel Code Committee's proposals to amend the U.K. Takeover Code in response to Kraft's acquisition of Cadbury, on the premise that well-founded takeover law and regulation should focus on fair process and leave socioeconomic factors and foreign investment regulation to other areas of the law. After outlining the United Kingdom's takeover regime and the Takeover Panel's review of the Takeover Code, this article offers a critique of two specific proposed reforms contained in the Takeover Panel Report. This article then questions the effectiveness of the regime under the Takeover Panel Report's proposals and introduces an alternative approach to fulfilling the Takeover Panel's goals that the Panel missed. This article concludes by calling for additional research to determine the proper course and proposals the Panel should take.

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I. INTRODUCTION

The international, cross-border merger boom has not been without social and political consequences. Cadbury/Kraft, a \$19 billion hostile-turned-friendly takeover in 2010, illustrated sound execution of the United Kingdom's board neutrality regime but tested a nation's resolve of its underlying policies. Kraft's pursuit of Cadbury was public and drawn-out, dating back to August 2009 when Cadbury management first received, and dismissed, a merger proposal from Kraft.¹ The ensuing battle did not result in a formal bid until November 2009 and involved: (1) numerous outside parties, including the U.K. Panel on Takeovers and Mergers (Takeover Panel), Nestle, Hershey's, and investor Warren Buffett,² and (2) a mandatory bid-or-walk-away order from the Takeover Panel.³ Cadbury shareholders, aided by short-term investors, arbitrageurs, and hedge funds that purchased shares after Kraft announced its initial interest in Cadbury, ultimately decided that the deal for the chocolate manufacturer was too sweet to pass up despite the Cadbury Board's opinion that the offer price was too low.⁴ Rather than succumb to the hostile bid, the Cadbury Board revised its position and negotiated a friendly sale to Kraft, agreed to Kraft's revised proposal in January 2010, and recommended that shareholders vote for the deal.⁵

In the months that followed the American company's acquisition of the 186-year-old British icon, Kraft reversed its stance against closing Cadbury plants in the United Kingdom and announced that it would close the Somerdale chocolate plant in Keynsham, despite widespread public protests and resistance from U.K. regulators.⁶ During the acquisition process, critics of the acquisition frequently cited Cadbury job losses as a likely outcome of the deal, but Kraft executives deflected these concerns during the bidding period and reiterated the company's

¹ David Jones, *TIMELINE—Kraft Agrees Cadbury Deal After 4-month Fight*, REUTERS, Jan. 19, 2010, <http://www.reuters.com/article/2010/01/19/cadbury-kraft-idUSLDE60E0XI20100119>.

² *Id.*; see also AP, *Warren Buffet Opposed Kraft-Cadbury Merger*, WASH. POST, Jan. 6, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/01/05/AR2010010503860.html> (discussing Berkshire Hathaway's, Warren Buffet's investment group, opinion on Kraft's purchase of Cadbury).

³ AP, *supra* note 2. A mandatory bid-or-walk-away deadline, also called a "put up or shut up" deadline, is a provision that was added to the Takeover Code in 2004 and designed to protect U.K. companies from prolonged siege and extended "virtual bid periods." Under this approach, a bidder must submit a formal bid within twenty-eight days of formally announcing an intention to make an offer for a target company. If the bidder has not yet made a formal announcement, the target company can request that the Takeover Panel implement a "put up or shut up" period that begins the twenty-eight day time period. See The Panel on Takeovers and Mergers, *The Takeover Code* r. 2.4, Mar. 30, 2009 (U.K.) [hereinafter *Takeover Code*]. The current version of the *Takeover Code* is available at <http://www.thetakeoverpanel.org.uk> (follow "Download Code as PDF" hyperlink).

⁴ Michael J. de la Merced & Chris V. Nicholson, *Kraft to Acquire Cadbury in Deal Worth \$19 Billion*, N.Y. TIMES, Jan. 19, 2010, <https://www.nytimes.com/2010/01/20/business/global/20kraft.html>.

⁵ *Id.*

⁶ Cecile Rohwedder & Alistair MacDonald, *Kraft Faces Probe on Cadbury*, WALL ST. J., Mar. 8, 2010, <http://online.wsj.com/article/SB10001424052748703915204575104002100336526.html> (citing Kraft's intent to move the Keynsham plant). *Contra* de la Merced & Nicholson, *supra* note 4 (quoting Kraft executives that it would be a "net importer" of jobs into the United Kingdom).

stance on increasing jobs in the United Kingdom.⁷ After the sale, Kraft announced that it would shift the manufacturing activities of this plant to Poland. This announcement further angered the local workforce and labor unions and provoked a growing sense of economic nationalism.⁸ This decision prompted the Takeover Panel to investigate whether Kraft misled investors.⁹ Since the Takeover Panel can only levy private and public reprimands, the investigation was not a true threat to Kraft.¹⁰

Facing mounting public pressure and backlash from Cadbury's acquisition, in February 2010, the Takeover Panel commenced a review of the City Code on Takeovers and Mergers (Takeover Code) with particular focus on the regulations that govern the unsolicited takeovers of U.K. companies. The Takeover Panel cited Kraft's takeover of Cadbury and public comments made by former Cadbury chairman Roger Carr urging changes as reasons for the review.¹¹ The Takeover Panel released a lengthy consultation paper on June 1, 2010, entitled "Consultation Paper Issued by the Code Committee of the Panel: Review of Certain Aspects of the Regulation of Takeover Bids" (Consultation Paper), and invited comments regarding potential changes to the Takeover Code.¹² After receiving public feedback from nearly 100 sources, the Takeover Panel Code Committee (Code Committee)¹³ issued a report entitled "The Takeover Panel Code Committee Review of Certain Aspects of the Regulation of Takeover Bids" (Takeover Panel Report) on October 21, 2010—just nine months after Cadbury signed its agreement with Kraft.¹⁴ While the Takeover Panel Report does not specifically mention the Cadbury/Kraft acquisition, its tone is deliberate that the Takeover Panel does not want another British icon to go the way of Cadbury and places a newfound emphasis on non-shareholder constituencies in the hostile bidding and takeover context.¹⁵

⁷ See sources cited *supra* note 6.

⁸ See Jonathan Petre, *The Last Curly Wurly in Britain: End of the Line for Cadbury Factory that Kraft Vowed to Keep Open*, THE DAILY MAIL, Jan. 2, 2011, <http://www.dailymail.co.uk/news/article-1343391/Somerdale-Cadbury-plant-End-line-factory-Kraft-vowed-open.html>.

⁹ Zoe Wood, *Takeover Panel to Look into Kraft's Closure of Cadbury Factory*, THE GUARDIAN, Mar. 8, 2010, <http://www.guardian.co.uk/business/2010/mar/08/kraft-cadbury-closure-takeover-panel>.

¹⁰ Takeover Code, *supra* note 3, at § A(11)(b); THE TAKEOVER PANEL CODE COMMITTEE, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS, 2010, Consultation Paper Issued by the Code Committee of the Panel PCP 2010/2, 1, [hereinafter CONSULTATION PAPER], <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201002.pdf>.

¹¹ CONSULTATION PAPER, *supra* note 10, at 1–2.

¹² *Id.* at 2.

¹³ The Code Committee, one of the Takeover Panel's two committees, is charged with the Takeover Panel's rulemaking functions. Takeover Code, *supra* note 3, at § A(4)(b).

¹⁴ THE TAKEOVER PANEL CODE COMMITTEE, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS 1–2 (2010) [hereinafter TAKEOVER PANEL REPORT] available at <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/2010-22.pdf>; see also Jessica Hodgson & Dana Cimilluca, *U.K. to Overhaul Merger Rules*, WALL ST. J., Oct. 21, 2010, available at <http://online.wsj.com/article/SB10001424052702304023804575565712776857050.html> (reporting the details of the Takeover Panel Report).

¹⁵ TAKEOVER PANEL REPORT, *supra* note 14, at 3. Cf. CONSULTATION PAPER, *supra* note 10, at 1 (referencing the Cadbury/Kraft merger and the widespread public debate that followed).

Major events often cause substantial legal reforms,¹⁶ but the public policy driving proposed revisions in the law should be unbiased and sound. This article will critique the proposals contained in the Takeover Panel Report on the premise that well-founded takeover law and regulation should focus on fair process and leave socioeconomic factors and foreign investment regulation to other areas of the law.¹⁷ After outlining the United Kingdom's takeover regime and the Takeover Panel's review, this article will critique two specific proposed reforms contained in the Takeover Panel Report, and will point out an alternative proposal the Takeover Panel missed that could better satisfy its goals.¹⁸ This article will conclude by calling for additional research.

II. THE EVOLVING U.K. TAKEOVER REGIME

The Takeover Code, first introduced in 1968, is a collection of mandatory rules governing companies that are listed on national stock exchanges in the United Kingdom and have their registered offices in the United Kingdom.¹⁹ The Takeover Code's mission is to ensure fair treatment of shareholders and promote integrity in the financial markets.²⁰ The Takeover Code focuses on accurate and sufficient disclosure of information to shareholders so that they may decide on the merits of a takeover, and on equal and fair treatment of all shareholders in takeovers.²¹ Additionally, the Takeover Code places certain restrictions on company boards so that they may not interfere with shareholders considering the merits of a takeover proposal or undertake actions that would frustrate meaningful shareholder choice.²² The Takeover Code, however, is not concerned with the business, strategic, or financial benefits or risks of takeovers and expressly states that these benefits and risks are to be judged by target companies and their shareholders.²³ Further, the Takeover Code disclaims any position on antitrust or competition matters.²⁴

The United Kingdom has long been a leading proponent of open markets, company neutrality, and shareholder empowerment in the face of hostile bids.²⁵ To understand the effect of this regime, consider the

¹⁶ See, e.g., Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered titles of the U.S.C.).

¹⁷ Michael R. Patrone, *An International Comparison of Corporate Leeway to Ward-Off Predators*, 25 BUTTERWORTHS J. INT'L BANKING & FIN. LAW 355, 358 (2010), available at <http://ssrn.com/abstract=1743845>.

¹⁸ There are several other proposed changes that merit analysis and review, but the length of this article requires a narrower scope.

¹⁹ Takeover Code, *supra* note 3, § A(3)(a).

²⁰ *Id.* § A(2)(a).

²¹ *Id.*

²² E.g., *id.* at r. 21.

²³ *Id.* § A(2)(a).

²⁴ *Id.*

²⁵ See generally Companies Act, (2006), Vol. 3 CURRENT LAW 1, (U.K.); Companies Act, (1985), Vol. 1 Current Law 1, (U.K.).

U.S. merger boom of the 1980s.²⁶ With the advent of junk bond financing and creative schemes like two-tier, front-end loaded tender offers,²⁷ hostile bidders could take over target companies with futile resistance by economically coercing the target's shareholders into quickly tendering their shares.²⁸ This approach was a method of choice for raiders in the United States, where the only real obstacle was the limited federal protection of the Williams Act—requiring tender offers to be held open for twenty days.²⁹ Before the shareholder rights plan, dubbed the “poison pill,” U.S. companies and shareholders were at the mercy of hostile acquirers.³⁰

Shareholders in the United Kingdom, however, did not face this dilemma. Under the Takeover Code, which applies to all listed companies headquartered in the United Kingdom, two-tier tender offers are prohibited.³¹ Additionally, under mandatory bidding requirements, a shareholder must bid for all of the target's shares once he or she obtains control.³² Unlike other jurisdictions, company control in the United Kingdom is met at a much lower threshold for regulatory purposes, and is defined in the Takeover Code as “an interest, or interests, in shares carrying in aggregate 30% or more of the voting right . . . of a company, irrespective of whether such interest or interests allow de facto control.”³³ The United Kingdom incorporated these provisions into the Companies Act of 1985, and retained them in the U.K. Companies Act of 2006 that officially gave the Takeover Code a statutory basis.³⁴ The Takeover Code still contains these provisions today.³⁵

In light of the many protections that the Takeover Code affords shareholders, it also restricts the actions of management in the face of a bid for the company.³⁶ The Board Neutrality Rule, a cornerstone of the

²⁶ See generally CONNIE BRUCK, *THE PREDATORS' BALL: THE INSIDE STORY OF DREXEL BURNHAM AND THE RISE OF THE JUNK BOND RAIDERS* (Penguin Books 1989) (1988) (highlighting Michael Milken's career developing risky, and perhaps fraudulent, schemes for financing corporate takeovers); BRYAN BURROUGH & JOHN HELYAR, *BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO* (Harper Business 2008) (1990) (detailing the leveraged buyout of RJR Nabisco).

²⁷ A two-tier front-end loaded tender offer, also called a “Saturday night special,” is a coercive offer structure. Typically, the raider offers cash on a first-come, first-served basis for the first-tier (the number of shares needed to obtain majority control) and subordinated notes for the second-tier (the remaining shares). See Patrone, *supra* note 17.

²⁸ See *id.* at 355.

²⁹ Securities and Exchange Act of 1934, 15 U.S.C. § 78 (2010) (as amended by the Williams Act of 1968).

³⁰ See generally MOIRA JOHNSTON, *TAKEOVER* (Beard Books 2000) (1986) (explaining the hostile takeover process through the lens of three historic examples).

³¹ See, e.g., Takeover Code, *supra* note 3, § B(1).

³² *Id.* at r. 9.1(a); see also CONSULTATION PAPER, *supra* note 10, at 10 (citing the Takeover Code, *supra* note 3, at § B(1), “if a person acquires control of a company, the other holders of securities must be protected”). For the parallel provision in the European Union Directive on Takeover Bids, see Council Directive 2004/25, art. 5, 2004 O.J. (L 142) 12, 17 (EC) [hereinafter Directive].

³³ Takeover Code, *supra* note 3, § C; see also Directive, *supra* note 32 (“The percentage of voting rights which confers control . . . shall be determined by the rules of the Member State in which the company has its registered office.”).

³⁴ Companies Act, (2006), Vol. 3 CURRENT LAW 1, 804–19 (U.K.).

³⁵ Takeover Code, *supra* note 3, §§ A(3), C(6).

³⁶ E.g., *id.* at r. 21.1.

U.K. takeover regime, prevents management from taking any frustrating action when it has reason to believe that a bona fide bid for the company is imminent.³⁷ If management wishes to undertake such action, it can do so only with advance approval of shareholders at a general meeting.³⁸ Thus, U.K. companies cannot enact takeover defenses or engage in other tactics that would prevent shareholders from considering a direct bid.³⁹ Management's role in this scenario is limited to communicating information with shareholders, and is mandated by the Takeover Code to express an informed opinion on the merits of the bid with the aid of unbiased, independent advisors.⁴⁰

In addition to its storied role in the United Kingdom, the Takeover Code served as the model for the European Union Directive on Takeover Bids (Directive), which includes such provisions as the aforementioned mandatory bidding rule and the Board Neutrality Rule.⁴¹ Furthermore, the Takeover Code's General Principles are identical to those in the Directive.⁴² The United Kingdom formally adopted the Directive by virtue of the Companies Act of 2006, but this had little practical effect on the rules that govern hostile takeovers in the United Kingdom since its laws already contained most of the provisions.⁴³

The Companies Act of 2006, in addition to providing a statutory basis for the Takeover Code, gave the Takeover Panel a defined role and statutory powers.⁴⁴ The Takeover Panel was established by statute in 1968, along with the Takeover Code, as an independent body whose membership is comprised of professionals appointed by governmental bodies, non-governmental organizations, and the Takeover Panel itself.⁴⁵ The Panel is charged with overseeing and regulating the transactions that the Takeover Code governs, including the bidding process and mergers.⁴⁶ The role of the Takeover Panel grew and strengthened in 2006 when it became the regulatory authority that oversees and implements the Directive in the United Kingdom, in addition to administering the Takeover Code.⁴⁷ As the regulatory watchdog on mergers and acquisitions in the United Kingdom, the Takeover Panel has a powerful voice with companies, the government, and the public, giving substantial weight to its recommendations for changes to the Takeover Code.⁴⁸

³⁷ *Id.*

³⁸ *Id.*

³⁹ *See id.*; *see also* Patrone, *supra* note 17, at 356.

⁴⁰ *See* CONSULTATION PAPER, *supra* note 10, at 66–67.

⁴¹ Directive, *supra* note 32, at art. 9; *see also* Takeover Code, *supra* note 3, § A(2)(b).

⁴² *See* Directive, *supra* note 32, at art. 3; Takeover Code, *supra* note 3, § A(2)(b).

⁴³ *See* Companies Act, (2006), Vol. 3 CURRENT LAW 1, 804–48 (U.K.).

⁴⁴ Takeover Code, *supra* note 3, § A(3); CONSULTATION PAPER, *supra* note 10, at 1–2.

⁴⁵ Takeover Code, *supra* note 3, § A(4)(a); *see also* Panel Membership, THE TAKEOVER PANEL, <http://www.thetakeoverpanel.org.uk/structure/panel-membership> (last visited Dec. 5, 2011).

⁴⁶ Takeover Code, *supra* note 3, § A(1); *see also* About the Panel, THE TAKEOVER PANEL, <http://www.thetakeoverpanel.org.uk/structure/about-the-panel> (last visited Dec. 5, 2011).

⁴⁷ CONSULTATION PAPER, *supra* note 10, at 1–2.

⁴⁸ *E.g.*, Matthew Curtin, *Evolution, Not Revolution, for U.K. Takeover Rules*, WALL ST. J., Oct. 21, 2010, <http://online.wsj.com/article/SB10001424052702304023804575566133711792398.html>.

III. THE TAKEOVER PANEL'S REVIEW OF THE TAKEOVER CODE AND REVISED PHILOSOPHY

On February 24, 2010, the Takeover Panel announced the beginning of its review of the Takeover Code, citing widespread public and government criticism about the Takeover Code in light of Kraft's acquisition of Cadbury.⁴⁹ The Takeover Panel's review of the Takeover Code is flawed because the Takeover Panel changed its focus from shareholders to stakeholders, and it failed to perform enough research to support its proposals. These flaws are evident in the Takeover Panel's reason for initiating the review, the review process itself, and the conclusions of the review.

A. *The Takeover Panel Lost Sight of its Focus to Protect Shareholders*

The Takeover Panel reiterated the concern that the Takeover Code fosters an environment where hostile bidders can too easily take control of companies.⁵⁰ Neither the mission of the Takeover Code nor the governing general principles, however, lists protecting target companies from hostile bidders as an objective of the takeover regime. The Takeover Code identifies shareholders, not companies, as the constituency that the Takeover Code seeks to protect.⁵¹ Despite the Takeover Code's focus on shareholders, the Takeover Panel never suggests that the U.K. takeover regime disadvantages shareholders, and never asserts that Cadbury's shareholders did not receive adequate protection from the Takeover Code, unless it was implying indirectly that Kraft had misled Cadbury shareholders about its plan to move production to Poland.⁵²

As part of the Consultation Paper's invitation for comments, the Takeover Panel presented general statistics about company bids for the four years leading up to the Takeover Panel's review process.⁵³ Of the

⁴⁹ CONSULTATION PAPER, *supra* note 10, at 1–2.

⁵⁰ *Id.* at 3–4.

⁵¹ See Takeover Code, *supra* note 3, §§ A(1)–A(2), B(1)–B(6).

⁵² See *id.*; CONSULTATION PAPER, *supra* note 10, at 3–4; TAKEOVER PANEL REPORT, *supra* note 14, at 3.

⁵³ CONSULTATION PAPER, *supra* note 10, at 4. The Takeover Panel provided the following data for the four-year period in the United Kingdom ending Mar. 31, 2010:

Type of bid	Total	Percent of all bids
Formal offers for U.K. companies	472	-
Formal offers not initially recommended by the target's board	72	15.25%
Formal offers still not recommended by the target's board when published	55	11.65%
Formal published offers still not recommended by the target's board at the end of the offer period	40	8.47%
Successful offers not recommended by the target's board at the end of the offer period	27	5.72%
Offers that lapsed at the end of the offer period	13	2.75%

472 offers made for U.K. companies during that period, the targets' boards disapproved of only seventy-two (15%).⁵⁴ Of these hostile offers, shareholders approved only twenty-seven and the rest either lapsed or turned into friendly negotiations such as Cadbury and Kraft.⁵⁵ Thus, in the four years prior to the Takeover Panel's investigation, only 15% of bids were true hostile offers, and of those, only 37.5% led to a takeover.⁵⁶ Put differently, of the 472 offers made during a four-year span that included a merger wave, only 6% were successful hostile bids—an average of seven hostile takeovers per year.⁵⁷ One would expect this number to be higher in light of the blanket U.K. prohibition against companies frustrating bids.⁵⁸

Despite these statistics, and lack of any other empirical or statistical evidence, the Code Committee concluded, in the Takeover Panel Report, that it is too easy for hostile bidders to take over companies under the current U.K. takeover regime, and that the Takeover Code puts companies in a disadvantaged position, which is detrimental to shareholders.⁵⁹ The Code Committee cited the views of commentators and respondents, but neither identified who these commentators and respondents were nor explained their views in any detail other than the general conclusion that companies have an unfair disadvantage to hostile bidders.⁶⁰ Further, the Code Committee failed to explain how a disadvantage to companies is a de facto disadvantage to shareholders, particularly in a context where companies' and shareholders' interests can sharply diverge.⁶¹

After hastily concluding that the Takeover Code disproportionately provides an advantage to hostile bidders, the Code Committee examined the negative effects that this advantage has upon companies and their employees, but not shareholders.⁶² These negative effects led the Code Committee to suggest changes to the Takeover Code to alleviate the perceived injustices.⁶³ The Code Committee even listed the role of shareholders under the Takeover Code as a factor that gives hostile bidders a tactical advantage and has a negative effect on companies.⁶⁴ This approach is troublesome because the Takeover Code's mission is to protect shareholders, not target companies and their employees.⁶⁵

⁵⁴ *Id.*

⁵⁵ *See id.*

⁵⁶ *See id.*

⁵⁷ *Id.*

⁵⁸ *See* Takeover Code, *supra* note 3, at r. 21; CONSULTATION PAPER, *supra* note 10, at 4.

⁵⁹ TAKEOVER PANEL REPORT, *supra* note 14, at 3.

⁶⁰ *Id.* The Code Committee did, however, list the names of the ninety-seven respondents who did not comment on a confidential basis. *Id.* at 26.

⁶¹ *Id.*

⁶² *Id.* at 3, 8, 9, 10.

⁶³ *Id.* at 10.

⁶⁴ *See id.* at 4.

⁶⁵ *See* Takeover Code, *supra* note 3, § A(2)(a) (stating that the purpose of the code is “to ensure that shareholders are treated fairly and are not denied an opportunity to decide on the merits of a takeover and that shareholders of the same class are afforded equivalent treatment by an offeror”).

Further, the Code Committee's aim at "redressing the balance in favour of the offeree company"⁶⁶ is misguided because it is facially outside the scope of the Takeover Panel's duties and it is substantively unclear whether it will benefit shareholders.⁶⁷

The Takeover Panel, as the agency that administers the Takeover Code, was justified in its decision to conduct a review.⁶⁸ The problems with its review, however, begin with the manner in which it was conducted. First, the Takeover Panel should have conducted a meaningful study to determine whether hostile bidders are unduly advantaged under the current U.K. takeover regime. Relying instead on the views of commentators and respondents without citing any evidence other than a list of factors is both arbitrary and capricious. As the organization charged with protecting the interests of shareholders, the Takeover Panel should have been more thorough and truly investigated the effects of the current takeover regime instead of relying upon the wave of polarized public opinion following the Cadbury/Kraft acquisition.⁶⁹

To improve its review process, the Takeover Panel could have collected additional data on both hostile and friendly bids in the United Kingdom and comparable jurisdictions to determine the U.K. takeover regime's effect on hostile bidders and companies.⁷⁰ Such information as acquisition premiums, bid conditions, and forms of consideration would be very helpful in determining whether hostile bidders have an unfair advantage in the United Kingdom and would have allowed the Code Committee to conduct a more meaningful analysis. Data from the United States would be helpful for comparison as well, as its takeover regime allows target companies broad leeway to respond to unsolicited takeover bids, including adopting takeover defenses and undertaking frustrating action, so long as it is reasonable.⁷¹

B. The Takeover Code with the Board Neutrality Rule Appears to Have Been Effective

The United Kingdom, by adopting the Board Neutrality Rule in the Takeover Code and adopting the Directive, consciously decided to limit the role of target company management in the face of a bid by leaving the bulk of the responsibility and authority to target company shareholders.⁷² It should come as no surprise then, that companies like Cadbury must look to their shareholders to fend off a hostile takeover

⁶⁶ TAKEOVER PANEL REPORT, *supra* note 14, at 3.

⁶⁷ See Takeover Code, *supra* note 3, §§ A(2)(a), B(1)–B(6).

⁶⁸ See Companies Act, (2006), Vol. 3 CURRENT LAW 1, 804-5 (U.K.).

⁶⁹ See Takeover Code, *supra* note 3, § A(1).

⁷⁰ The data contained in the Consultation Paper was a good start, but is insufficient to conduct a meaningful statistical analysis on the effects of The Takeover Code on hostile bids. See CONSULTATION PAPER, *supra* note 10, at 4. An empirical study on the issue would be very worthwhile before the United Kingdom amends The Takeover Code.

⁷¹ *E.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953–55 (Del. 1985).

⁷² See Takeover Code, *supra* note 3, at r. 21; Directive, *supra* note 32, at art. 9.

and may only disseminate information and express an opinion on the bid under the Takeover Code.⁷³ Thus, it is misguided to argue that hostile bidders have an unfair advantage over target companies because the Takeover Code deliberately restrains target companies so that their shareholders have the freedom to evaluate the merits of a bid for the company and decide whether to accept or reject the offer.⁷⁴ The focus of the inquiry should instead be whether hostile bidders have an unfair advantage over target company shareholders under the current U.K. takeover regime.⁷⁵ The Code Committee, unfortunately, never directly made that distinction but instead concluded that the hostile bidder had an advantage over the target company and therefore over company's shareholders.⁷⁶

Second, the Takeover Panel should have investigated whether a hostile bidder's advantage actually has a negative effect on the shareholders of target companies.⁷⁷ Even if the Takeover Panel's investigation found that the current takeover regime makes it "too easy" for hostile bidders to succeed, it is highly unlikely that the data would show that this advantage has any meaningful impact on shareholders. This conclusion naturally flows from the very Guiding Principles that the Takeover Code is based upon—that all shareholders should be treated equally and that target shareholders, not target companies, should be the true decision makers in takeovers.⁷⁸ Since a majority of shareholders must approve any takeover, and the Takeover Code requires all shareholders to receive equal consideration for their shares, it is hard to imagine a situation where a hostile bidder's advantage would negatively affect shareholders, unless the shareholders felt a sentimental attachment to their shares of the target company. The Takeover Code's mandatory bidding rules further bolster this position, as a hostile bidder can only buy up to 29.9% of a company on the open market before having to make a bid for the remainder of the shares at a fair price.⁷⁹ Thus, the protections of the Takeover Code probably negate any hostile bidder's advantage.

To evaluate whether a hostile bidder advantage indeed has a negative effect on shareholders, the Takeover Panel could have utilized the same data for acquisition premiums, bid conditions, and form of consideration used to determine whether hostile bidders have an advantage.⁸⁰ Further,

⁷³ Takeover Code, *supra* note 3, at r. 21.

⁷⁴ *Id.* §§ B(1)–B(3); *see also id.* at r. 21.

⁷⁵ *See id.* § B.

⁷⁶ *See* TAKEOVER PANEL REPORT, *supra* note 14, at 3 (“[T]he Code Committee has concluded that hostile offerors have, in recent times, been able to obtain a tactical advantage over the offeree company to the detriment of the offeree company and its shareholders.”).

⁷⁷ *See id.*

⁷⁸ *See* Takeover Code, *supra* note 3, §§ B(1)–B(6); *see also* Rohwedder & MacDonald, *supra* note 6.

⁷⁹ Takeover Code, *supra* note 3, at r. 9.1(a); *see also* CONSULTATION PAPER, *supra* note 10, at 10 (citing General Principle 1 of the City Code on Takeovers and Mergers, “[I]f a person acquires control of a company, the other holders of securities must be protected.”).

⁸⁰ *See* sourced cited *supra* notes 68–69.

data from shareholder votes on solicited and unsolicited bids would be helpful as well, as a narrow majority could indicate a negative effect on shareholders when compared to offers that receive a substantial majority of shareholder votes.⁸¹ Data from comparable regions and the United States would also be helpful to put the report's statistics in a meaningful context.⁸² Without supporting evidence, however, the Takeover Panel Code Committee's hasty conclusion that hostile bidders have a tactical advantage, and that this advantage negatively affects companies and shareholders, threatens the integrity of the Takeover Code and its Guiding Principles.⁸³

In addition to conducting an insufficient review process, the Code Committee misinterpreted and wrongly distorted the Takeover Code's philosophy and mission by taking it upon itself to protect the interests of U.K. companies and employees rather than shareholders.⁸⁴ The Companies Act and Takeover Code clearly state that the Takeover Panel's objective is to ensure that shareholders have sufficient information and free choice, not to help U.K. companies remain independent.⁸⁵ Companies have boards of directors and employees have unions and labor officials to serve their interests; the Takeover Panel's duty is to protect shareholders.⁸⁶

The Takeover Panel undoubtedly came under significant pressure from both the public and government officials after Kraft's acquisition of Cadbury, but this pressure is misplaced on the Takeover Panel and should instead be directed at Cadbury's shareholders. Kraft's hostile-turned-friendly acquisition of Cadbury was a textbook example of the U.K. takeover regime functioning properly: Kraft made a bid directly to shareholders and the Cadbury board, after gauging shareholder sentiment, negotiated a friendly merger with Kraft.⁸⁷ Shareholders, not the Takeover Panel, decided to accept Kraft's proposal and facilitated the sale of the British icon to a non-British company.⁸⁸ Further, although Kraft indicated that it was averse to job cuts in the United Kingdom, layoffs are a common—if not expected—result of mergers and buyouts as consolidating operations and eliminating duplicative functions are

⁸¹ This data, however, may instead only be indicative of the acquisition premium.

⁸² See sources cited *supra* notes 68–69.

⁸³ Compare TAKEOVER PANEL REPORT, *supra* note 14, at 3 with Takeover Code, *supra* note 3, §§ B(1)–B(3).

⁸⁴ See Takeover Code, *supra* note 3, §§ B(1)–B(6). *But see* Companies Act, (2006), Vol. 3 CURRENT LAW 1, 804 (U.K.) (“The Panel may do anything that it considers necessary or expedient for the purposes of, or in connection with, its functions.”). The Code Committee recognized that certain proposed changes would significantly enlarge the scope of the Takeover Code, but failed to recognize that the Takeover Panel Report's focus on companies and their employees achieves this undesired result. See TAKEOVER PANEL REPORT, *supra* note 14, at 5.

⁸⁵ Takeover Code, *supra* note 3, § A(1). See Companies Act, 2006, 804 (U.K.) (“The Panel may do anything that it considers necessary or expedient for the purposes of, or in connection with, its functions.”).

⁸⁶ See sources cited *supra* note 85.

⁸⁷ See Patrone, *supra* note 17, at 358; Jones, *supra* note 1.

⁸⁸ de la Merced & Nicholson, *supra* note 4.

traditional means of achieving merger value.⁸⁹ Cadbury shareholders, by supporting Kraft's acquisition proposal, may have decided that Kraft's offer price provided more value for their shares than the combination of Cadbury's inherent long-term value, its 186-year storied history, and the additional jobs an independent Cadbury provides to the United Kingdom.⁹⁰ The report, however, failed to mention how much Kraft's assurances affected shareholder decision making. Thus, the public criticism on the Takeover Code is misplaced and should instead focus on target company shareholders—whose apparent values and priorities, as evidenced by their actions, differ from those of the critics who support U.K. takeover reform. If a majority of Cadbury shareholders wished for Cadbury to remain independent and wished to keep jobs in the United Kingdom, they would most likely have voted “no” on the merger proposal and Kraft would not have acquired Cadbury. As company shareholders and owners, however, they are free to sell their stakes as they please.

As a foremost advocate for free markets, the United Kingdom established a takeover regime that seeks to impose as little restraint as possible—from either government or target companies—on both solicited and unsolicited bids.⁹¹ The Takeover Panel, as an independent regulatory agency, should be free from political pressures and economic nationalism sentiment and should continue its focus on ensuring fair treatment of shareholders, rather than shift course and seek to protect U.K. companies and their employees as the Code Committee proposes.⁹² Economic nationalism and job losses, not shareholder disadvantages, are the foundation of the public criticism surrounding the Cadbury/Kraft acquisition.⁹³ These interests are better left to other areas of law, like labor and foreign investment, rather than takeover regulation.⁹⁴ Instead of caving under public pressure and heeding to the political winds, the Takeover Panel and Code Committee should have reiterated its position as an independent, unbiased, and objective regulator whose purpose is to ensure the unprejudiced, fair treatment of shareholders.⁹⁵ The Takeover Panel Code Committee's silently revised philosophy is without merit and the Takeover Code should not adopt it.⁹⁶

⁸⁹ See BRUCE WASSERSTEIN, *BIG DEAL: THE BATTLE FOR CONTROL OF AMERICA'S LEADING CORPORATIONS* 76–77, 164–70 (1998).

⁹⁰ While Cadbury shareholders did not expressly state this choice, it is inherent in their “yes” vote on the merger proposal. Some shareholders may argue that they did not support cutting Cadbury jobs in the United Kingdom, but this could have easily been made a condition to the merger agreement.

⁹¹ See Takeover Code, *supra* note 3, § B; Patrone, *supra* note 17, at 356, 358.

⁹² See Takeover Code, *supra* note 3, §§ A, B; TAKEOVER PANEL REPORT, *supra* note 14, at 3.

⁹³ See Rohwedder & MacDonald, *supra* note 6.

⁹⁴ Patrone, *supra* note 17, at 358.

⁹⁵ Companies Act, (2006), Vol. 3 CURRENT LAW 1, 804–5 (U.K.); Takeover Code, *supra* note 3, § A(1).

⁹⁶ See Takeover Code, *supra* note 3, §§ A(2), B(1)–B(6).

IV. THE TAKEOVER PANEL'S PROPOSALS WILL LIKELY HURT SHAREHOLDERS

An analysis of the Takeover Panel's proposals shows that some of the proposals may fail to benefit and in fact may hurt the shareholders. The first proposal changes the virtual bid period, and the second removes deal protection measures and break fees.

A. *The Virtual Bid Period Proposal*

In the Takeover Panel Report, the Code Committee recommended shortening the virtual bid period, placing additional requirements on potential acquirers during and after the virtual bid period, and expanding the list of triggers for the proposed four-week offer period.⁹⁷ The Code Committee believes that the existing virtual bid period gives offerors a "tactical advantage," stating that the "virtual bid period . . . can be long and drawn-out and this can adversely affect the conduct of the offeree's business and the offeree company board's negotiating position with an offeror."⁹⁸ The Code Committee believes that the current Section D "put up or shut up" regime is effective, but that a potential offeror can avoid this regime by announcing "that it is considering making an offer but without committing itself to doing so."⁹⁹ The Code Committee believes that this leaves target companies "under siege" from unsolicited offerors for prolonged periods of time, which prevents the company from focusing on its normal business.¹⁰⁰ This concern is somewhat ironic since management operates the company's business for the benefit of its shareholders, but it is possible that a prolonged virtual bid period may decrease productivity and therefore the enterprise and market value of the company's shares. It is curious, then, that the Code Committee did not cite this concern and rather focused upon target companies' management and employees as the intended beneficiaries of this rule.¹⁰¹

The Code Committee's oversight, however, does not end with protecting the incorrect constituencies from prolonged virtual bid periods. To fix the perceived imbalance from virtual bid periods in favor of offerors, the Code Committee recommended further regulating the bid period, specifically amending the Takeover Code to require that an announcement be made following an approach, naming the potential offeror, which triggers the Section D "put up or shut up" period of the Takeover Code.¹⁰² The Code Committee proposed a rule that allows either the potential offeror or target to make the announcement.¹⁰³ From

⁹⁷ TAKEOVER PANEL REPORT, *supra* note 14, at 11; *see also* CONSULTATION PAPER, *supra* note 10, at 66.

⁹⁸ TAKEOVER PANEL REPORT, *supra* note 14, at 4.

⁹⁹ *See id.* at 11 (defining "virtual bid"); *see also* sources cited *supra* note 3 (explaining the Section D "put up or shut up" regime).

¹⁰⁰ TAKEOVER PANEL REPORT, *supra* note 14, at 12.

¹⁰¹ *See id.* at 11.

¹⁰² *Id.*; *see also* Takeover Code, *supra* note 3, § D.

¹⁰³ TAKEOVER PANEL REPORT, *supra* note 14, at 11.

the date of the announcement, the potential offeror will have twenty-eight days to announce either a firm intention to make an offer, under Rule 2.5, or that it will not make an offer and be subject to the Rule 2.8 six-month regulatory standstill period.¹⁰⁴ The only exception to the twenty-eight day period the Code Committee provides is if both the offeror and offeree company jointly petition the Takeover Panel to extend the timeline for good cause.¹⁰⁵

While it is true that unsolicited acquisition interest can be disruptive to a company's operations, the Code Committee's recommendations focus on this tangential issue to the detriment of the underlying acquisition process itself. Mergers, acquisitions, and potential takeovers are, by nature, disruptive. The sale of a company is the most significant and emotional point in its history.¹⁰⁶ Thus, it is understandable that a byproduct of the process may be a distraction from the target companies' day-to-day activities, but to spite the entire process in the name of partially alleviating one of the side effects is irrational and ultimately harms the very constituency that the Takeover Panel is protecting—the shareholders.¹⁰⁷

First, the ability of the target company to unilaterally start the four-week offer period gives the target company's insiders—not shareholders—undue leverage over a potential acquirer that can be exploited for self-interest.¹⁰⁸ Because the target company is not required to share information with the potential offeror, the potential offeror must operate without the data it may need to determine whether an offer for the entire company is feasible. The potential offeror will have access to publicly available information through other sources, but this alternative due diligence process will inevitably take additional time. Thus, a target company can put a potential acquirer at a substantial disadvantage by triggering the start of the offer period and requiring the potential acquirer to make an offer decision before it is ready to do so.¹⁰⁹ Even if the Takeover Code requires the company to show cause or some other substantiation before it announces the identity of a potential offeror and triggers the twenty-eight day offer period, ensuring that the potential offeror or its agent did indeed approach the target, over-eager investment bankers hunting for a deal or arbitrageurs fishing for tips could

¹⁰⁴ *Id.*; see also Takeover Code, *supra* note 3, at r. 2.5, 2.8.

¹⁰⁵ TAKEOVER PANEL REPORT, *supra* note 14, at 11.

¹⁰⁶ I borrowed the sentiments for this comment from my Mergers and Acquisitions professor at Harvard Law School, the Honorable Chancellor Leo. E. Strine, Jr., to whom I am indebted for my appreciation of corporate law.

¹⁰⁷ See Takeover Code, *supra* note 3, § A(2)(a).

¹⁰⁸ There are many examples where courts are concerned with the possibility the board is acting in its own self-interest. See, e.g., *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (Moore, J.) (“Because of the *omnipresent specter* that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . .”) (emphasis added). It is important to note that while I certainly do not suggest that the Delaware courts have binding authority over U.K. law, the principles of equity—namely, the fiduciary duty of loyalty—in the United States and United Kingdom share the same common ancestry. See generally SARAH WORTHINGTON, EQUITY 8–12 (2d ed. 2006).

¹⁰⁹ See TAKEOVER PANEL REPORT, *supra* note 14, at 11.

inadvertently satisfy this requirement.¹¹⁰ This also would be unfair to potential offerors and place them at a tactical disadvantage that is not justified by the minor “siege” the target company faces from a virtual bid period.¹¹¹

Second, even if the target company does not preemptively trigger the start of the offer period, the four-week offer period still puts the potential offeror at an undue disadvantage because, unlike in friendly negotiations, the potential offeror is not guaranteed access to the target’s nonpublic information before or during the offer period, and the Takeover Panel Report makes no recommendations for allowing potential offerors access to this information.¹¹² Thus, a potential offeror will be burdened in its due diligence process when deciding whether to make an offer, and may not be able to make the determination at the end of the four-week period. Because companies are only required to make public filings at certain intervals, a target company can strategically time its information releases to frustrate the potential offeror’s due diligence process and ensure that the information needed to determine whether an offer is financially feasible is unavailable.

Because the Code Committee’s proposed changes only provide for an exception to the four-week period if *both* the potential offeror and target company jointly petition the Takeover Panel, the Code Committee’s proposal to shorten the virtual bid period is likely to result in three different outcomes, none of which benefit the shareholders of target companies. First, companies who are not prepared to decide whether to make a bid at the end of the four-week period are more likely not to make offers and be subject to the six-month regulatory standstill period. Because potential acquirers will always bid higher than the current market price for all of the target company’s shares, shareholders will lose this opportunity to realize more value for their shares.¹¹³ Second, potential offerors who have been rushed in their decision-making processes but decide to still make bids will adjust for the increase in uncertainty and risk by offering less for the targets’ shares to compensate for the higher risk premium.¹¹⁴ This is unfortunate for shareholders of target companies because potential acquirers presumably would offer more per share if they had additional time to complete their due diligence, which ultimately results in target company shareholders

¹¹⁰ *See id.*

¹¹¹ *See id.* at 12–13.

¹¹² *See id.*

¹¹³ While there is no rule that requires offeror companies to bid higher than the current market price, an offeror could always purchase shares on the open market and simply pay the market price, without offering a premium, in the short run. *But see* Takeover Code, *supra* note 3, at r. 9.1 (requiring a shareholder to make a bid for the remainder of a company’s shares once he attains control, as defined an aggregate of 30% or more of a company’s voting rights).

¹¹⁴ For example, a potential offeror may use an equation like $P = E(1 + G)^N / (1 + R)^{N+1}$ to value the company’s stock at time $N+1$, where P is the price the offeror will pay, E is earnings per share, G is the growth rate of earnings, N is the number of years that the earnings will grow, and R is the desired rate of return. Uncertainty and risk will decrease G and increase R , thus driving down P . *See generally* JAMES ENGLISH, APPLIED EQUITY ANALYSIS: STOCK VALUATION TECHNIQUES FOR WALL STREET PROFESSIONALS (2001).

realizing less value for their shares. Finally, potential acquirers may make highly conditional offers or later withdraw their offers upon learning new information.¹¹⁵ This is also a terrible scenario for target companies and target company shareholders because other investors will see the targets as damaged goods and the target's shares are likely to decline in market value.

It is important to note that the primary constituency for the Takeover Panel is shareholders, but the Code Committee failed to present any evidence or arguments that indicate that a shortened offer period benefits shareholders.¹¹⁶ Additionally, only two potential counterarguments were presented in the initial Consultation Paper: (1) that the target company "is only truly under 'siege' . . . once the fact of the potential offeror's approach has been publicly disclosed and an offer period has commenced," and (2) the target company can "resolve the situation by publicly disclosing the potential offeror's existence and identity and seeking a 'put up or shut up' deadline from the Panel immediately thereafter."¹¹⁷ Foremost, these potential counterarguments do not address the issues facing shareholders. Further, these counterarguments were not even addressed by the Takeover Panel Report.¹¹⁸ Before accepting the premises that (1) the virtual bid period places an undue burden on target companies by subjecting them to being "under siege" for prolonged periods, and (2) this "siege" is detrimental to shareholders of target companies, the Code Committee should have conducted a meaningful study and gathered empirical data to establish or rebut the validity of these concerns.¹¹⁹ Instead, the Code Committee wrongly accepted these two assertions as given and used them as the basis for its first proposed amendment to the Takeover Code.¹²⁰

¹¹⁵ *But see* Takeover Code, *supra* note 3, at r. 2.4, n. 1 (placing certain requirements on conditions and pre-conditions to offers).

¹¹⁶ See TAKEOVER PANEL REPORT, *supra* note 14, at 11–13.

¹¹⁷ CONSULTATION PAPER, *supra* note 10, at 74; *see also* Takeover Code, *supra* note 3, at r. 2.4 (permitting a target company to request the Takeover Panel to impose a deadline for the potential offeror to clarify its intentions. The Takeover Panel will only impose such a deadline, however, upon request from the target's Board of Directors).

¹¹⁸ See TAKEOVER PANEL REPORT, *supra* note 14, at 11–13.

¹¹⁹ The Consultation Paper presented statistics on the number of "put up or shut up" deadlines that the Takeover Panel set since Rule 2.4's introduction in 2004. CONSULTATION PAPER, *supra* note 10, at 70. From August 2004 to March 2010, the Takeover Panel imposed "put up or shut up" deadlines in sixty-one instances on sixty-seven potential offerors. Of these, twenty-four (35.8%) announced firm intentions to make offers and forty-two announced that they would not make an offer (62.7%). *Id.* The remaining potential offeror had its "put up or shut up" deadline withdrawn at the request of the target company's board of directors. *See id.* These statistics, however, only indicate the number of *instances* of "put up or shut up" deadlines, and not the *effect* of these deadlines or the extent of losses target companies suffered as a result of being "under siege" during the virtual bid period. An empirical study on the issue would be very worthwhile before the United Kingdom amends The Takeover Code.

¹²⁰ TAKEOVER PANEL REPORT, *supra* note 14, at 10, 11–13.

B. The Proposal to Prohibit Deal Protection Measures and Break Fees

The Code Committee's second proposed amendment in the Takeover Panel Report is for the Takeover Code to impose a general prohibition on deal protection measures and inducement fees "strengthening the position of the offeree company."¹²¹ As with the virtual bid period, the Code Committee made this recommendation without conducting any empirical studies or collecting any data whatsoever on deal protection measures and inducement fees.¹²² Further, the majority of comments that the Code Committee received favored allowing, but further regulating, inducement fees so long as they are *de minimis* (generally capped at 1% of the offer price), as well as deal protection measures.¹²³ Thus, the Takeover Panel Report's recommendation has neither the support of data nor public sentiment, and the Code Committee instead rests its argument solely upon its own arbitrary conclusion that these measures lead to fewer competing offers and less favorable terms for competing offers, citing only the "Panel Executive's experience of current market practice."¹²⁴ The Code Committee also proposed that there should be an exception to this prohibition of inducement fees and deal protection measures in the limited situation where a target undertakes a formal, public auction process to sell the company.¹²⁵

The Code Committee asserted that it needs to prohibit deal protection measures and inducement fees, rather than leave potential offerors and target companies to bargain over such matters in the free market, because the Code Committee believes that target companies are at a substantial disadvantage and cannot negotiate with offerors at arm's length.¹²⁶ The Code Committee further believes that it has become common practice for offerors to insist on the highest allowable inducement fees and maximum permissible deal protection measures, despite the absence of any supporting data.¹²⁷ Assuming, *arguendo*, that the Code Committee made a genuine factual finding on the issue and was concerned about unduly burdensome inducement fees and deal protection measures, why not simply recommend reducing the maximum allowable inducement fee and restricting allowable deal protection measures instead of banning them altogether?¹²⁸ Further, if these measures are so detrimental to target companies and their shareholders, why does the Takeover Panel Report recommend an exception to the prohibition for public auctions of companies?¹²⁹

¹²¹ *See id.* at 10, 13–16.

¹²² *See id.* at 13–16; *Cf. id.* at 14 (citing the Takeover Panel Executive's "experience of current market practice," but not any data or the results of any studies).

¹²³ *Id.* at 13–14.

¹²⁴ *Id.* at 14.

¹²⁵ *Id.* at 16.

¹²⁶ *Id.* at 14.

¹²⁷ *See id.*

¹²⁸ *See id.*

¹²⁹ *See id.* at 16.

The Takeover Panel Report's approach to inducement fees, commonly referred to as "break fees" or "termination fees" in the United States,¹³⁰ is misguided and ultimately deprives target company shareholders from realizing the full value of their shares. Inducement fees are generally only payable after specific triggering events—usually the target board recommending a competing offer after entering into an acquisition agreement with the offeror.¹³¹ Currently, inducement fees are permissible under the Takeover Code so long as (1) they are *de minimis* (usually capped at 1% of the offer price), and (2) the target company confirms to the Takeover Panel that it believes the inducement fee is in its shareholders' best interests.¹³² The Code Committee offered no evidence, however, to show that this regime unduly disadvantages target companies.¹³³ Instead, the Takeover Panel Report arbitrarily relies on the argument in the Consultation Paper that inducement fees "may lead to a reduction in shareholders' funds . . . without any clear benefit being obtained by offeree company shareholders."¹³⁴

In addition to not providing any evidence on inducement fees, the Code Committee failed to respond to any counterarguments to its position in the Takeover Panel Report.¹³⁵ The sole argument that the Takeover Panel introduced in favor of inducement fees, that an offeror may not be willing to make an offer in the absence of an inducement fee, was only addressed in the initial Consultation Paper and only focuses on a narrow area of potential offers.¹³⁶ While the absence of inducement fees may indeed dissuade potential offerors from making offers in certain instances, the argument fails to capture the larger picture of how inducement fees can provide value to offerors and shareholders alike. It is well established, and can be partially inferred from the Consultation Paper's potential counterargument, that conducting due diligence and entering into an agreement to purchase a company is both time consuming and expensive for potential offerors. These costs must be accounted for by the offeror, and are often defrayed by the use of inducement fees in the event that the deal falls apart. Thus, if the Takeover Panel bans inducement fees, two outcomes are likely, and both are worse for target company shareholders than the current regime. First,

¹³⁰ The Takeover Code and Code Committee define an inducement fee as "an arrangement which may be entered into between an offeror or a potential offeror and the offeree company pursuant to which a cash sum will be payable by the offeree company if certain specified events occur which have the effect of preventing the offer from proceeding or causing it to fail (e.g. the recommendation by the offeree company board of a higher competing offer)." CONSULTATION PAPER, *supra* note 10, at 81–82 (citing Takeover Code, *supra* note 3, at r. 21.2, n. 1).

¹³¹ *See id.* at 82.

¹³² Takeover Code, *supra* note 3, at r. 21.2; *see also* CONSULTATION PAPER, *supra* note 10, at 82.

¹³³ *See* TAKEOVER PANEL REPORT, *supra* note 14, at 13–16.

¹³⁴ CONSULTATION PAPER, *supra* note 10, at 83; *see also* TAKEOVER PANEL REPORT, *supra* note 14, at 14.

¹³⁵ *See* TAKEOVER PANEL REPORT, *supra* note 14, at 14; *see also* CONSULTATION PAPER, *supra* note 10, at 83.

¹³⁶ *See* CONSULTATION PAPER, *supra* note 10, at 83; *see also* TAKEOVER PANEL REPORT, *supra* note 14, at 13–16.

as the Consultation Paper suggests, there will likely be fewer offers for companies.¹³⁷ This is because offerors may identify targets they can acquire for attractive prices, but may be unable to afford their own offer-related costs for any one or more of three reasons: the deal falls apart, management revises its stance and instead recommends another offer, or shareholders vote against the proposed deal.

Alternatively, potential acquirers are likely to offer lower prices for target companies if the Takeover Code bans inducement fees. This can be explained through the two essential prongs of an offer: price and certainty.¹³⁸ Inducement fees both increase the likelihood that the target's shareholders will approve the agreed-upon acquisition and that the potential acquirer will be reimbursed for part of its expenses if the deal falls apart. In an efficient market, which the United Kingdom strives to maintain, this increase in certainty—and corresponding decrease in risk—will be of considerable value to the potential acquirer and accordingly something for which the potential acquirer will increase its bid. Although the risk of paying the inducement fee if the deal is not consummated still exists for shareholders, this risk will be overshadowed in the long-run by the number of deals that will be completed at higher prices per share.¹³⁹

Other deal protection measures, in addition to inducement fees, similarly add value to a merger transaction and can be both valuable and beneficial to target company shareholders. The Code Committee failed to recognize this point, and instead recommended that the Takeover Code ban other deal protection measures as well, with very few exceptions. Notably, the Consultation Paper focused on exclusive inducement fee agreements, non-solicitation (or “no shop”) agreements, notification agreements, “matching rights” (or “topping rights”), confidentiality agreements, and “force the vote provisions.”¹⁴⁰ The Consultation Paper presented the counterargument, in favor of deal protection measures, that these measures are subject to the target company board's fiduciary duties.¹⁴¹ This creates a “fiduciary out,” but the Consultation Paper ultimately dismissed this point because it is likely to result in litigation over whether specific actions are proper discharges of fiduciary duties, which disadvantages target companies.¹⁴² The Code Committee addressed these measures in the same breath as inducement fees, and recommended a general prohibition against their use. The prohibition came with the following limited exceptions: instances where a company

¹³⁷ See CONSULTATION PAPER, *supra* note 10, at 83.

¹³⁸ Certainty can also be termed “risk.” I attribute the price and certainty approach to the excellent instruction I received from leading practitioners, specifically Mark Gordon of the law firm Wachtell, Lipton, Rosen & Katz and Peter J. Halasz of the law firm Schulte, Roth & Zabel.

¹³⁹ The Takeover Panel and Code Committee do not provide data to prove or disprove this assertion, but an empirical study on the issue would be very worthwhile before the United Kingdom amends The Takeover Code.

¹⁴⁰ See CONSULTATION PAPER, *supra* note 10, at 86–91 (briefly outlining these measures).

¹⁴¹ See CONSULTATION PAPER, *supra* note 10, at 92–93.

¹⁴² See *id.*

initiates a formal, public auction process to sell itself,¹⁴³ confidentiality agreements for sensitive information provided during the offer process, non-solicitation agreements for the offeror's customers or employees, and agreements to provide information necessary for regulatory approvals.¹⁴⁴

Once again, the Code Committee failed to provide any evidence or data to support its assertion that deal protection measures unduly harm target company shareholders and recommended that the Takeover Code be amended to impose a general ban on these measures.¹⁴⁵ While these measures may be restrictive on target companies and preclude target company shareholders from certain opportunities, they provide a great deal of certainty for offerors, for which offerors will compensate these shareholders. The Takeover Panel Report neither raised nor addressed this argument, which is unfortunate because the proposed amendment destroys this value for both potential offerors and target company shareholders. Similar to the ban on inducement fees, this Takeover Code amendment is likely to lead to fewer offers and lower offers for target companies, which ultimately deprives target company shareholders from realizing the full value of their shares.

The Takeover Panel Report and Consultation Paper focus a great deal on target companies not being able to bargain at arm's length for inducement fee arrangements and deal protection measures, asserting that these have become standardized in the market.¹⁴⁶ If this were truly the case, a more appropriate means of regulation would be to put target companies in arm's length bargaining positions with potential offerors rather than ban practices that generate value for which acquirers are willing to pay. The Takeover Panel Report's proposal, however, takes an overly paternalistic approach in its recommendation to prohibit these devices altogether—an approach under which there are no discernible winners and many losers, namely, shareholders.

V. AN ALTERNATIVE PROPOSAL – ABOLISH THE BOARD NEUTRALITY RULE

Even if the Takeover Panel meant to protect all stakeholders' interests, the Panel failed to identify a proposal that would potentially serve the stakeholders better—that is, to abolish the Board Neutrality Rule. The Code Committee now believes that the Takeover Code, including the Board Neutrality Rule, places companies at a substantial disadvantage to bidders and that the takeover framework should not unduly favor particular parties.¹⁴⁷ To fix this perceived shortfall in the takeover framework, though, the Code Committee advocates making the

¹⁴³ TAKEOVER PANEL REPORT, *supra* note 14, at 16.

¹⁴⁴ *Id.* at 15.

¹⁴⁵ *See id.* at 10, 13–16.

¹⁴⁶ *Id.* at 14; CONSULTATION PAPER, *supra* note 10, at 86, 91–93.

¹⁴⁷ *See supra* notes 58–67 and accompanying text.

process more difficult for would-be acquirers.¹⁴⁸ This approach does not make sense and is not consistent with the Takeover Code General Principles.¹⁴⁹ Assuming, *arguendo*, that the current takeover framework does indeed place companies at a substantial disadvantage,¹⁵⁰ why not alleviate this disadvantage by changing how the Takeover Code regulates target companies in the face of a hostile bid? Why is the United Kingdom so married to the idea of the Board Neutrality Rule if its own takeover watchdog unequivocally states that it places companies at a disadvantage?¹⁵¹

Within the Takeover Panel Report, there has been a significant shift in intended beneficiaries of the U.K. takeover regime, from the Code Committee's perspective.¹⁵² The Board Neutrality Rule originally protected shareholders and still exists to serve their interests and ensure that they can exercise meaningful choice when evaluating a friendly or hostile bid.¹⁵³ In making its proposals, however, the Takeover Panel Code Committee never substantively argued that the Board Neutrality Rule now disadvantages shareholders; it only argued that the rule disadvantages companies.¹⁵⁴ In order to rectify the situation, the Code Committee proposed that bidders and companies should both be disadvantaged for the takeover framework to fulfill its goal of serving shareholders.¹⁵⁵ The confusion does not stop there, however, because the Code Committee did not substantively argue that these proposals are designed to benefit shareholders, but other stakeholders—namely, employees.¹⁵⁶ The current framework under the Takeover Code is designed for the benefit of the shareholders, but it unduly disadvantages companies. If the Takeover Panel Report's proposals pass, the framework will equally disadvantage would-be acquirers and bidders, just to protect stakeholders the framework should not protect.¹⁵⁷

In order to best address the concerns introduced by the Code Committee, the United Kingdom would be better off abolishing the Board Neutrality Rule than implementing the Code Committee's recommended changes. The Board Neutrality Rule, strictly implemented, benefits shareholders because it guarantees they can consider a bid for the company without management taking defensive action to frustrate the bid.¹⁵⁸ Presumably, this will generate higher bids for shareholders because hostile bidders do not have to account for the cost of management's frustrating actions, takeover defenses, or waging a

¹⁴⁸ TAKEOVER PANEL REPORT, *supra* note 14, at 3–4.

¹⁴⁹ See Takeover Code, *supra* note 3, § B.

¹⁵⁰ A point that I disagree with and attempted to rebut earlier. See *supra* Part III.

¹⁵¹ TAKEOVER PANEL REPORT, *supra* note 14, at 4.

¹⁵² Compare Takeover Code, *supra* note 3, §§ B(1)–(6), with TAKEOVER PANEL REPORT, *supra* note 14, at 10.

¹⁵³ Takeover Code, *supra* note 3, at r. 21.1–2.

¹⁵⁴ See TAKEOVER PANEL REPORT, *supra* note 14, at 4.

¹⁵⁵ *Id.* at 2–4.

¹⁵⁶ See *id.* at 10.

¹⁵⁷ See *id.* at 2–4, 10.

¹⁵⁸ See Takeover Code, *supra* note 3, at r. 21.1–2.

takeover battle into the bid price. Although some distinguished practitioners argue that forcing a bidder to deal with the board is the best way to maximize shareholder value,¹⁵⁹ others argue that, in the simple context of a direct bid to shareholders, a rational bidder would bid a higher price if he did not have to expend resources to overcome resistance or finance a takeover battle.¹⁶⁰

This simple example changes, however, when the Takeover Panel's proposed amendments to the Takeover Code enter into the equation.¹⁶¹ At this point, it is unclear whether the Board Neutrality Rule and the Takeover Panel's new proposals for bidders or a regime like Delaware's, where bidders may negotiate with management,¹⁶² will more effectively maximize shareholder value.¹⁶³ From a strategic standpoint, however, one would presume that a would-be bidder would place a premium on being subject to fewer government regulations and higher deal certainty. Additionally, from a public policy standpoint, it seems far more desirable to have a takeover framework where bidders and companies are able to utilize all of their resources and act in their highest capacity.¹⁶⁴ A potential takeover, whether successful or not, is a very disruptive and significant point in a company's history,¹⁶⁵ so the Panel's reasoning for recommending the new proposals is irrelevant. Therefore, leaving both the would-be acquirer and target company to utilize their business judgment and all available tools is the most desirable way for the takeover regime to govern this situation. Under the Takeover Code and the Takeover Panel's proposed changes, however, the situation is akin to sending two men out to duel with slingshots rather than guns.

Further, the Takeover Panel subtly suggests an enlarged group of Takeover Code beneficiaries by stating that the Takeover Code should "take more account of the position of persons who are affected by

¹⁵⁹ *E.g.*, Mark Gordon, *Takeover Defenses Work. Is That Such a Bad Thing?*, 55 STAN. L. REV. 819, 824–25 (2002).

¹⁶⁰ *See id.* *But see* John C. Coates IV, *The Contestability of Corporate Control: A Critique of the Scientific Evidence on Takeover Defenses* 70–74, Harvard Law Sch. John M. Olin Ctr. for Law, Econ., and Bus. Discussion Paper No. 265 (Sept. 1999), available at http://www.law.harvard.edu/programs/olin_center/papers/pdf/265.pdf (Professor Coates, the John F. Cogan, Jr. Professor of Law and Economics at Harvard Law School, cites several studies that show that companies with poison pills both received higher takeover premiums and outperformed the stock market in non-takeover situations. The article criticizes these studies, however, as being insufficient and potentially misleading and concludes that takeover defenses have no conclusive effect on stock price. Professor Coates argues, rather, that the mere availability of takeover defenses has the desired effect but that their adoption rarely has any effect.)

¹⁶¹ *See* TAKEOVER PANEL REPORT, *supra* note 14, at 10.

¹⁶² Unless the bidder makes a direct offer to shareholders in the form of a tender offer. *See, e.g.*, John Armour & David A. Skeel, Jr., *The Divergence of U.S. and UK Takeover Regulation*, REGULATION, Fall 2007, www.cato.org/pubs/regulation/regv30n3/v30n3-8.pdf.

¹⁶³ The Takeover Panel and Code Committee do not provide data to prove or disprove this assertion, but an empirical study on the issue would be very worthwhile before the United Kingdom amends its Takeover Code.

¹⁶⁴ *But cf.* Takeover Code, *supra* note 3, at r. 21.1 (requiring the board of the offeree company to obtain shareholder consent before taking any action that might frustrate a bona fide offer or possible offer, or deny shareholders the opportunity to accept or reject an offer on its merits).

¹⁶⁵ *See* TAKEOVER PANEL REPORT, *supra* note 14, at 4.

takeovers in addition to offeree company shareholders.”¹⁶⁶ If the Takeover Panel is serious about this goal, abolishing the Board Neutrality Rule would be a better approach to protecting non-shareholder stakeholders than recommending additional regulations. The best way to protect these interests is to allow company management to exercise its business judgment when evaluating takeover proposals and determining an appropriate response, which may include undertaking actions to frustrate the bid.¹⁶⁷

After serving as the model for board neutrality in the Directive, there has been changing sentiment in the United Kingdom about company law. The Code Committee is taking a much more pro-company approach to the takeover regime, yet maintains that the current regime need only be altered to alleviate its disproportionate effect on companies and, indirectly, employees.¹⁶⁸ It is understandable that the United Kingdom would not advocate for repealing the Board Neutrality Rule given its heritage and role as model for the Directive.¹⁶⁹ Thus, deeming the Board Neutrality Rule unfair and repealing it would be detrimental—if not catastrophic—to the efforts to uniformly implement the newly-passed Directive, specifically Article 9 on board neutrality. From a practical standpoint, repealing the Board Neutrality Rule so that companies could engage in takeover defense activities could be the best way to protect both shareholders and stakeholders. The Takeover Panel, as an independent agency free from the political process, should consider this proposal as a means of alleviating the negative effects a hostile-bidder’s advantage has upon target company shareholders—if such negative effects exist.

VI. CONCLUSION

Throughout the Consultation Paper and the Takeover Panel Report, the Takeover Panel and Code Committee repeatedly suggest that boards of target companies either cannot or will not represent and protect their shareholders’ interests in the United Kingdom’s free market. Accordingly, the Takeover Panel believes that the Takeover Code should be less permissive and more paternalistic in order to ensure that shareholders’ interests are served. Sadly, this approach ignores the fiduciary and representative relationship that company directors share with their shareholders. If directors are unwilling to represent and serve the interests of shareholders, then shareholders will exercise their voting rights and elect new directors who will. If directors are unable to defend or serve shareholders’ interests, then shareholders will do so themselves by adopting provisions to strengthen their companies and by instructing

¹⁶⁶ *Id.* at 3.

¹⁶⁷ See Martin Lipton, *Takeover Bids in the Target’s Boardroom*, 35 BUS. LAW. 101, 103–04 (1979).

¹⁶⁸ See TAKEOVER PANEL REPORT, *supra* note 14, at 3, 10.

¹⁶⁹ See Directive, *supra* note 32, at art. 1, 3; Takeover Code, *supra* note 3, § A(2)(b).

their directors to take additional measures and seek assistance. If offerors try to coerce or take advantage of shareholders, then shareholders will simply vote against the offerors and continue to enjoy the liberties and protections of the Takeover Code and the shareholder democracy philosophy.

Unfortunately, these proposed amendments are not about shareholders at all, even if they pretend to be. The Takeover Code allows target companies to protect their shareholders and ensures that shareholders can protect themselves. The Takeover Code does not, however, allow target companies to protect their employees, their national heritage, or themselves at the expense of shareholders. Regrettably, these ideals are what the proposed amendments aim to achieve, even though many other areas of law already address them. The Takeover Panel, the world's oldest institution on mergers and acquisitions, simply could not maintain its independence in the face of immense public outcry and government pressure. It did not want to bear the blame for allowing British icons to be swallowed by foreign corporate giants and for allowing U.K. jobs to be shipped overseas. So, although the Takeover Panel's post-Cadbury proposal will serve many constituencies if adopted, it will harm the group that needs the Takeover Code's protection most: the shareholders.

This article raises more questions than it answers, but it is better to examine the law thoroughly and to carefully consider alternatives than to rush to legislate after an undesirable event occurs. Emotion and rhetoric are no substitutes for data and evidence, and the desire to eliminate all potentially negative side effects of a hostile takeover cannot overshadow the importance of a well-founded body of takeover law. Perhaps the Takeover Panel's recommendations will ultimately benefit shareholders, but there is no way to know without further research, and thus the Takeover Panel should conduct more research before enacting its proposals.