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Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation

John Armour
Oxford University

David A. Skeel Jr.
University of Pennsylvania Carey Law School

ARTICLES

Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation

JOHN ARMOUR* AND DAVID A. SKEEL, JR.**

Hostile takeovers are commonly thought to play a key role in rendering managers accountable to dispersed shareholders in the "Anglo-American" system of corporate governance. Yet surprisingly little attention has been paid to the very significant differences in takeover regulation between the two most prominent jurisdictions. In the United Kingdom, defensive tactics by target managers are prohibited, whereas Delaware law gives U.S. managers a good deal of room to maneuver. Existing accounts of this difference focus on alleged pathologies in competitive federalism in the United States. In contrast, we focus on the "supply-side" of rule production by examining the evolution of the two regimes from a public choice perspective. We suggest that the content of the rules has been crucially influenced by differences in the mode of regulation. In the United Kingdom, self-regulation of takeovers has led to a regime largely driven by the interests of institutional investors, whereas the dynamics of judicial law-making in the United States have benefited managers by making it relatively difficult for shareholders to influence the rules. Moreover, it was never possible for Wall Street to "privatize" takeovers in the same way as the City of London, because U.S. federal regulation in the 1930s both pre-empted self-regulation and restricted the ability of institutional investors to coordinate.

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* Faculty of Law, University of Oxford; European Corporate Governance Institute.

** University of Pennsylvania Law School.

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"More rubbish than wisdom has been talked about takeover bids."[1]

INTRODUCTION

A distinguishing feature of the so-called "Anglo-American" system of corporate governance is that share ownership in public corporations is dispersed. The authors of the leading empirical studies on corporate ownership note, for instance, that "in the United States and the U.K. . . . [even medium-sized] firms remain mostly widely held—a testimony to the attractiveness of selling out in the United States and the U.K."[2] A key mechanism for rendering managers accountable to shareholders is the market for corporate control: namely, the threat that if the managers fail to maximize the share price, the company may become an acquisition target. Given that this mechanism is thought to be pivotal

1. *Queensberry Rules for Bids*, ECONOMIST, Oct. 31, 1959, at 440.
2. Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471, 497 (1999).

to making dispersed ownership viable, it is strange that so little attention has been paid to the significant differences in the way in which takeovers are regulated *between* the two systems that together comprise the "Anglo-American model." Both the *mode* and the *substance* of the regulation are startlingly different.

In the United Kingdom, takeovers are regulated by the City Code on Takeovers and Mergers (the "Takeover Code"), a body of rules that is written and administered by the Panel on Takeovers and Mergers (the "Takeover Panel"). Staffed by personnel on secondment from the professional community that it regulates, and untrammeled by the procedural and precedential niceties of the courtroom, the Panel responds in a flexible and well-informed fashion to disputes and governs their resolution in "real time." In contrast, most U.S. takeovers are governed by the courts of Delaware. As courts go, these are quick and flexible, but they nevertheless tend to lend an *ex post* flavor to dispute resolution.

The content of takeover regulation differs just as markedly on the two sides of the Atlantic. In the United Kingdom, the Takeover Code is strongly weighted toward protecting the interests of shareholders. The Code's equal treatment and mandatory bid requirements prevent acquirers from making coercive bids. Moreover, unless shareholders consent, the Code strictly prohibits management from employing any defensive tactics that would have the effect of frustrating an actual or anticipated bid. In contrast, management in the United States has a good deal more flexibility to engage in defensive tactics, provided that these can be justified in accordance with their fiduciary duties.

These differences raise a number of interesting questions. First, how are the divergences between these two superficially similar systems to be explained? At the level of substance, why is Delaware's jurisprudence so much friendlier to managers than the British Takeover Code? In answer, some scholars point to the dynamics of competitive federalism in the United States. In an environment characterized by regulatory competition, the winning "product"—that is, Delaware law—will reflect the preferences of the group which does the "buying." In the view of Lucian Bebchuk and others, the managers of listed corporations have undue influence over the choice of corporate governing law, and hence, it has tended to favor their cause in takeovers.[3]

3. *See, e.g.*, Lucian Arye Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111, 113–14, 117 (2001); Lucian Arye Bebchuk & Allen Ferrell, *On Takeover Law and Regulatory Competition*, 57 BUS. LAW. 1047, 1047 & n.1 (2002). In his important and much-publicized work arguing for more shareholder choice in American corporate governance, Bebchuk is one of the few corporate scholars who have even noticed the contrast between the U.S. and U.K. approaches to corporate governance. Bebchuk focuses on the substance of the regulation, arguing that U.S. lawmakers should adopt rules that give shareholders more authority, as in the United Kingdom, without delving into the striking differences as to who the regulators are in the two countries and the context in which takeovers are regulated. *See* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 847–50 (2005). The difference in regulatory mode, we will argue, holds the key to understanding takeover regulation in the two countries.

In contrast, our account does not require an assumption that U.S. managers have effective control over the choice of corporate law—the veracity of which is, of course, a hotly contested question. Rather, we suggest that the *mode* of regulation has influenced—indeed, determined—its *substance*. By mode, we mean who the regulators are and the context in which the regulation takes place: informal guidance by the Takeover Panel in the United Kingdom, Delaware judges and the federal securities law in the United States. It is these differing modes of regulation that best explain why the substantive rules—which give almost complete authority to shareholders in the United Kingdom, but provide significant managerial discretion in the United States—look so different in the two countries. By exploring how and why the two countries adopted such differing modes of regulation, we can better understand the substantive differences in U.S. and U.K. oversight.

To reconstruct the history of British takeover regulation, we interviewed members of the Takeover Panel and surveyed contemporary newspaper accounts dating back to the 1950s, when hostile takeovers first emerged.[4] In the United Kingdom, the self-regulatory system was orchestrated principally by the community of investment bankers and institutional investors, all of whom regularly rub shoulders in the "City," the one-square-mile district where London's business community is located. Corporate managers were not a well-organized constituency, and they had, from an American perspective, surprisingly little say in the formulation of the regulation. Hence, it is hardly surprising that the rules were designed to protect the interests of shareholders. In the United States, on the other hand, the development of the rules has depended upon the accumulation of common law precedents.[5] The crucial point to understand here is that judges can only decide the cases which are brought before them—thus, the evolution of the common law depends upon the incentives parties have to litigate, as opposed to settle, disputes. Where particular groups of litigants are better organized or funded than others, the content of the law may be expected, over time, to develop in a manner favorable to their interests. In litigation over takeover disputes, directors have just such an advantage, because of the structure of takeover litigation. This claim, it should be understood, is not so much one about Delaware as about the common law—and it is buttressed by a remarkable parallel in the United Kingdom: English case law, which was the only source of regulation until the matter was "privatized" by the advent of the Takeover Code in the late 1960s, is similarly manager-friendly. Indeed, several

4. The interviews were conducted in January and February 2005 by John Armour and Jay Verjee. Jay did a masterful job both with the interviews and in constructing an initial history of the Takeover Panel.

5. For our assessment of the U.S. regulatory framework, we analyzed primary and secondary materials from the New Deal era, such as the legislative history of the securities acts and the papers and correspondence of key New Deal reformer William O. Douglas; studied the legislative history of the 1968 Williams Act and primary materials charting the 1967 amendments to the Delaware General Corporation law; researched contemporary newspaper accounts; and drew from a variety of other sources.

of the cases sound as if they might have been written by Delaware judges.

This leads naturally to a related question: If the substance of the regulation is determined by its mode, how in turn are the differences in process to be explained? In London, City professionals—in particular, institutional investors—avoided the need for *ex post* litigation by developing a body of norms, which eventually gave rise to the Takeover Code. These norms were, and still are, enforced by reputational sanctions such as the threat of exclusion from the London Stock Exchange, which ensured that contentious issues were resolved *ex ante* without the need for court involvement. On Wall Street, by contrast, self-regulation never took hold in the same way. At first blush, the absence of self-regulation by institutional shareholders in the United States may seem simply to reflect the fact that ordinary investors account for a much more significant proportion of stock ownership in the United States than the United Kingdom, and consequently U.S. institutional investors have never risen to own a similar proportion of listed stock as have their U.K. counterparts. As a result, coordination is less worthwhile for such investors, each of whom holds relatively little stock, and self-regulation is less likely to emerge.

Such a story, however, misses what we believe to be the crucial role of law in structuring these developments. As Mark Roe and others have described,[6] U.S. federal regulation before and during the 1930s restricted both the scale and the scope of services that financial institutions were permitted to provide, crucially undermining the ability of institutional investors to coordinate. This led not only to the relatively limited stock ownership by institutional as compared to retail investors, but also to an environment that was hostile to self-regulation. Indeed, federal securities legislation enacted during the same era directly prohibited the New York Stock Exchange, the principal source of self-regulation in the 1930s, from seeking to regulate a range of activities that have fallen within the purview of "soft law" in London. In the United Kingdom, by contrast, restrictive personal taxation, coupled with a safe harbor for pensions, greatly accelerated the development of collective investment vehicles. The United Kingdom's self-regulatory system was driven by the preponderance of institutional investors in the marketplace and a regulatory framework that trusted them to govern themselves; whereas the United States was characterized by many more retail investors and a popular mistrust of the "insiders" who controlled the financial institutions, reflected in the latter's being kept for so long on a tight regulatory leash.

These issues of regulatory development raise a normative question: Does one system have properties that make it preferable to the other? Previous scholars have paid little attention to the substantive differences between the two regimes and almost none to the far more important divergences in the mode of regula-

6. *See generally* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); Bernard S. Black & John C. Coffee, *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997 (1994).

tion. We consider that the United Kingdom's system has *prima facie* advantages in terms of procedure—it seems at once quicker, cheaper, and more certain than a system that relies upon litigation. Turning to substance, much ink has of course been spilled on the question of whether, and to what extent, defensive tactics should be permissible in the face of a hostile bid. We consider that the Takeover Code's "no frustrating action" rule, which prohibits poison pills and other defensive tactics, is likely to be preferable, but we recognize that the state of the empirical literature is such that we cannot make this claim emphatically.

Our account of the differences in the development of the two systems suggests that the choice of rulemaker—judges or self-regulatory bodies in this instance—can be just as important an influence on the substance of takeover law as regulatory competition. This has important implications for the future development of European takeover law. Issues of competitive federalism are becoming much more pertinent on the other side of the Atlantic in light of the European Court of Justice's ruling in the *Centros* case, which has increased the potential for regulatory competition in European company law.[7]

These developments, together with the increasing ownership of U.K. companies by non-U.K. institutions and the belated emergence of institutional shareholders as a force in U.S. corporate governance, pose a final question for U.S. and U.K. governance: Will the current differences endure? One can imagine the increasingly heterogeneous investment culture in the United Kingdom undermining U.K. self-regulation, and institutional shareholders pressing for a more shareholder-centered approach in the United States. But the sanctions that the Takeover Panel can employ in response to non-U.K. investors that flout its advice, the most effective of which is the ability to withdraw professional advisers' authorization to act in the London markets, are likely to counteract any erosion of the Panel's authority. In the United States, we doubt that the most active new investors—hedge funds—will seek broad-based changes to takeover regulation. Delaware oversight is effective enough, and the gains from sweeping changes in U.S. takeover regulation small enough, to preempt a systematic campaign by other institutions to alter the framework of U.S. regulation. We therefore suspect that the basic differences are deeply entrenched enough to survive even the radical changes that are underway in global securities markets.

The rest of this paper is structured as follows: Part I describes the differences

7. *See* Case C-212/97, Centros Ltd v. Erhvervs-og Selskabssyrelsen, 1999 E.C.R. I-1459 (holding that Danish authorities' refusal to recognize company incorporated in United Kingdom, on basis that it conducted no business in the United Kingdom and its only shareholders were Danes seeking to avoid minimum capitalization requirement in that country, was in contravention of E.U. Treaty). *See generally* John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, *in* AFTER ENRON 497 (John Armour & Joseph M. McCahery eds., 2006); Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477 (2004); Martin Gelter, *The Structure of Regulatory Competition in European Corporate Law*, 5 J. CORP. L. STUD. 247 (2005); Tobias H. Tröger, *Choice of Jurisdiction in European Corporate Law: Perspectives of European Corporate Governance*, 6 EUR. BUS. ORG. L. REV. 3 (2005).

between the U.S. and U.K. systems of takeover regulation and offers a comparative evaluation of the divergent processes and substance of takeover regulation in the two countries. Part II gives a historical account of their development. The reasons for their divergence are explored in Part III. Part IV explores some of the implications of the two approaches and speculates whether each is likely to endure.

I. TWO DIFFERENT SYSTEMS OF TAKEOVER REGULATION

Hostile takeovers are the nuclear threat of corporate law, the most dramatic of all corporate governance devices. A properly functioning takeover market enhances corporate governance in two related ways. If the bidder brings in better managers after the bid, or can improve the target's performance by reconfiguring its assets or exploiting synergies between the two firms, there is a direct, cause-and-effect relationship between the takeover and firm value. Takeovers have a second, indirect benefit as well. If managers have reason to suspect that a hostile bidder will swoop in and take control if they run the company badly, the prospect of a takeover can keep the managers on their toes.

For over twenty-five years, academics have debated the question of how best to regulate the takeover market. The more the merrier, argued Frank Easterbrook and Dan Fischel. Their passivity thesis proposed that managers be prohibited from defending against a takeover, so that the company's shareholders would be the ones who decided whether to accept the bid.[8] If the decision were left to the target's managers, the managers' interest in preserving their own jobs would too often overcome their fidelity to the best interests of the company. In response, other commentators argued that managers should be given at least some scope to slow down an initial takeover bid.[9] On this view, managers should be permitted to defend against a takeover to the extent necessary to get the best possible price for the company's shareholders.

In the United States, Easterbrook and Fischel's shareholder-oriented approach has been far more successful in theoretical debates than as an influence on actual practice. The Delaware courts have dismissed the shareholder choice perspective in several important takeover decisions, emphasizing instead that

8. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1164 (1981). The Easterbrook and Fischel approach has antecedents in the work of earlier scholars such as Henry Manne in the 1960s. *See* Henry Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 113 (1965); *see also* Ronald Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 819 (1981).

9. *See, e.g.*, John C. Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1149 (1984); Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037, 1037 (2002); Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 104–05 (1979).

the company is managed by or under the control of its directors.[10] If we look across the Atlantic, by contrast, we see a remarkably different picture. The United Kingdom has explicitly rejected managerial discretion in favor of the shareholder-oriented strategy for regulating takeovers. Less recognized but of even greater importance, the *mode* of takeover regulation also looks quite different in the United Kingdom than in the United States. In the discussion that follows, we describe the differences in more detail, and consider whether either approach can be said to be superior.

A. THE SUBSTANTIVE CONTOURS OF TAKEOVER REGULATION

Start with the substantive terms—the "what"—of takeover regulation. United States regulation gives bidders complete flexibility to bid for as small or as large of a percentage of the target company's stock as they wish. U.S. law has never imposed a "mandatory bid" rule requiring bidders who acquire a large block of target shares to make an offer for all of the target company's shares. U.S. tender offer regulation does require, however, that the bidder pay the same price for each of the shares it acquires; that the bidder purchase a pro rata amount of the shares of each shareholder who tenders her shares; and that it keep the bid open for at least twenty days.[11] The U.S. regulations thus protect shareholders against so-called "Saturday night special" bids that are kept open only for a short time and made available only to the first shareholders who tender in order to create pressure on shareholders to rush to tender. But they do not guarantee shareholders that they will be able to sell all of their shares if a bidder takes control of the company.

While U.S. regulation of tender offer bidders is relatively shareholder-friendly, the treatment of target managers' responsibilities in the face of an unwanted takeover bid is anything but. Managers of a target company are permitted to use a wide variety of defenses to keep takeover bids at bay. The most remarkable of the defenses is the poison pill or shareholder rights plan, which is designed to dilute a hostile bidder's stake massively if the bidder acquires more than a specified percentage of target stock—usually 10 or 15%. Poison pills achieve this effect—or more accurately, would achieve this effect if they were ever triggered—by, among other things, inviting all of the target's shareholders except the bidder to buy two shares of stock for the price of one. The managers of a company that has both a poison pill and a staggered board of

10. Footnote 16 of one of Delaware's most pro-takeover decisions, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184 (Del. 1985), for instance, is at pains to disclaim the Easterbrook and Fischel perspective, emphasizing that "we do not embrace the passivity thesis rejected in *Unocal*."

11. The principal U.S. tender offer regulations were enacted in connection with the 1968 Williams Act, which amended the Securities and Exchange Act of 1934. For a brief summary of the regulations, see MELVIN A. EISENBERG, CORPORATION AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 1136–40 (8th ed. unabr. 2000).

directors have almost complete discretion to resist an unwanted takeover bid.[12] In addition to poison pills and staggered boards, U.S. targets are also permitted other defenses, such as breakup fees and other "lockup" provisions that are designed to cement a deal with a favored bidder while keeping hostile bidders at bay.[13]

However, the discretion vested in target managers is not absolute. Managers are sometimes required to remove takeover defenses, as when the defenses tilt the playing field toward one bidder in the heat of an actively contested takeover battle. But target bidders have extensive discretion—particularly if they wish to "just say no" to any bid to acquire the company.[14] Moreover, while most of the nation's largest corporations are subject to Delaware law, and Delaware is by far the most important source of regulation, companies that are incorporated elsewhere also have broad (indeed, often much greater) discretion to defend against unwanted takeover bids. Nearly every state has enacted antitakeover legislation that is designed to slow down unwanted takeovers.[15] These laws use a wide variety of techniques to make it easier for managers to resist takeovers, ranging from provisions authorizing managers to take non-shareholder interests into account when they decide whether to resist a bid, to fair-price provisions limiting a bidder's flexibility to effect a subsequent combination after acquiring control, and control share provisions that strip the bidder of voting rights unless the remaining shareholders approve.[16]

In contrast to the United States, U.K. takeover regulation has a strikingly

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12. This point is made forcefully in Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002).

13. *See, e.g.*, John Coates & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307 (2000); David A. Skeel, Jr., *A Reliance Damages Approach to Corporate Lockups*, 90 NW. U. L. REV. 564 (1996).

14. Although the Delaware Supreme Court has never explicitly endorsed the "just say no" approach, and there are hints that the Delaware Chancery Court may reject it, at least for target companies that have both a staggered board and a poison pill, target managers are seen as having broad discretion to defend against an unwanted takeover bid. The debate over "just say no" was spurred by the Delaware decision in *Paramount Communications, Inc. v. Time Inc.*, 637 A.2d 34 (Del. 1989). For discussion, see, for example, Leo E. Strine Jr., *The Professorial Bear Hug: The ESB Proposal as a Conscious Effort to Make the Delaware Courts Confront the Basic 'Just Say No' Question*, 55 STAN. L. REV. 863 (2002). Vice Chancellor Strine's statements and rulings are seen by some as evidence that Delaware's judges may adopt a less deferential stance, at least for targets that have a staggered board of directors. *See, e.g.*, David Bank, *How a Judge's Ruling May Curb 'Poison Pill' as Takeover Defense*, WALL ST. J., Dec. 13, 2004, at B1.

15. The first generation of state antitakeover statutes was struck down in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), largely because they purported to govern any corporation doing business in the state. States' lawmakers subsequently revised their antitakeover statutes to apply only to companies incorporated in the state. The second generation statutes were upheld in *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987).

16. *See, e.g.*, MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 1117 (9th ed. Unabridged 2005)(defining "fair-price"provisions); Roberta Romano, *A Guide to Takeovers: Theory Evidence and Regulation*, 9 YALE J. REG. 119, 168-173 (1992)(describing fair-price, control shares and other antitakeover provisions and surveying empirical studies on their effect).

shareholder-oriented cast.[17] The most startling difference comes in the context of takeover defenses. Unlike their U.S. brethren, U.K. managers are not permitted to take any "frustrating action" without shareholder consent, once a takeover bid has materialized.[18] Poison pills are strictly forbidden and so is any other defense that will have the effect of impeding target shareholders' ability to decide on the merits of a takeover offer, such as buying or selling stock to interfere with a bid, or agreeing to a lockup provision with a favored bidder.[19]

To be sure, the "no frustrating action" principle of the U.K.'s Takeover Code only becomes relevant when a bid is on the horizon. It might be thought that managers seeking to entrench themselves would take advantage of this less stringent *ex ante* regulation to "embed" takeover defenses well before any bid comes to light.[20] "Embedded defenses" could range from the fairly transparent, such as the issuance of dual-class voting stock, adopting a staggered board appointment procedure, or the use of "golden shares" or generous golden parachute provisions for managers—to the more deeply embedded, such as provisions in bond issues or licensing agreements that provide for acceleration or termination if there is a change of control.

Yet in U.K. practice, embedded defenses are not observed on anything like the scale that they are in the United States. This is partly because of various other aspects of the U.K.'s corporate governance environment, which restricts directors' ability to entrench themselves. For example, English company law requires directors to seek approval from the general meeting for authority to issue new shares,[21] and in listed companies this will usually only be granted subject to guidelines formalized by institutional investors.[22] Dual-class voting stock, though not directly prohibited, is strongly frowned upon by institutional investors,[23] and a company that seeks to issue it will suffer a severe price

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17. On the U.K. regulation, see generally THE PANEL ON TAKEOVERS AND MERGERS, THE CITY CODE ON TAKEOVERS AND MERGERS (8th ed. 2006) (U.K.), http://www.thetakeoverpanel.org.uk/new/codesars/DATA/code.pdf [hereinafter TAKEOVER CODE]; LEXISNEXIS BUTTERWORTHS, TAKEOVERS: LAW AND PRACTICE (Gary Eaborn ed., 2005); WEINBERG AND BLANK ON TAKE-OVERS AND MERGERS (William Underhill ed., 5th ed. 1989 & Supp. 2006) [hereinafter WEINBERG & BLANK].

18. TAKEOVER CODE, *supra* note 17, Rule 21, at I14–16; *see also id.*, Gen. Principle 3, at B1.

19. *See* LEXISNEXIS BUTTERWORTHS, *supra* note 17 at 394–96, 419–20, 436–37; WEINBERG & BLANK, *supra* note 17, §§ 4-7038, 4-7092 to 4-7130B.

20. This strategy is discussed in Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577, 582–83 (2003); Richard E. Kihlstrom & Michael L. Wachter, *Corporate Policy and the Coherence of Delaware Takeover Law*, 152 U. PA. L. REV. 523 (2003).

21. Companies Act, 2006, c. 2, §§ 549–51 (Eng.); *see also* Companies Act, 1985, c. 6, § 80 (Eng.).

22. *See* ASS'N OF BRITISH INSURERS, DIRECTORS' POWERS TO ALLOT SHARE CAPITAL AND DISAPPLY SHAREHOLDERS' PRE-EMPTION RIGHTS (1995 & Amend. 1999) (U.K.), http://www.ivis.co.uk/pages/gdsc1_1.PDF.

23. G.P. STAPLEDON, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE 58–59 (1996); WEINBERG & BLANK, *supra* note 17, § 4-7077 (noting rarity of dual-class issues and a number of instances where proposals to issue dual-class shares have been dropped following hostility from institutional investors).

penalty in raising capital.[24] In addition, preemption rules provide that directors must offer any new shares first to existing shareholders pro rata with their holdings.[25] The force of staggered board mechanisms is destroyed by a mandatory rule that shareholders may remove directors at any time by ordinary resolution,[26] and a combination of provisions limiting the extent to which "golden parachute" provisions in executive service contracts can entrench managers.[27]

As in the United States, U.K. bidders are subject to an equal treatment rule that requires them to pay the same price to all shareholders wishing to accept a tender offer.[28] However, the U.K. rules go considerably further in promoting equal treatment of target shareholders, so as even to require that anyone purchasing what amounts to a controlling stake (deemed to occur on acquisition of 30% or more of the voting rights in the target's share capital)[29] must make an offer (known as a "mandatory bid") for the remainder of the target's share capital.[30] To be sure, this provision, which is intended to protect minorities by ensuring that all shareholders get the opportunity to share in the payment of a control premium,[31] is not unequivocally pro-shareholder.[32] By restricting the

24. For example, non-voting shares typically trade at a discount of 10-20%. WEINBERG & BLANK, *supra* note 17, § 4-7073.

25. FIN. SERVS. AUTH. (FSA), FSA HANDBOOK: LISTING RULES 9.3.11–12 (U.K.), http://fsahandbook.info/FSA/html/handbook/LR [hereinafter U.K. LISTING RULES]; *see also* Companies Act, 2006, c. 3, §§ 560–77 (Eng.); Companies Act, 1985, c. 6, §§ 89–96 (Eng.). The pre-emption rights regime may be relaxed with shareholder approval, but institutional investor guidelines provide that this will only be granted in limited circumstances. *See* PRE-EMPTION GROUP, DISAPPLYING PRE-EMPTION RIGHTS: A STATEMENT OF PRINCIPLES (2006) (U.K.), http://www.pre-emptiongroup.org.uk/documents/pdf/disapplyingpre-emption rightsstatementofprinciples.pdf.

26. *See* Companies Act, 2006, c. 1, § 168 (Eng.); *see also* Companies Act, 1985, c. 6, § 303(1) (Eng.).

27. *See* Companies Act, 2006, cc. 6 & 9, §§ 420–22, 439–40 (Eng.) (requiring annual publication by listed companies of detailed report on directors' remuneration and precatory vote by general meeting on its contents); *see also* Directors' Remuneration Report Regulations, 2002, S.I. 2002/1986 §§ 234B, 241A, Sched. 7A (U.K.) (same); FIN. SERVS. AUTH., THE COMBINED CODE ON CORPORATE GOVERNANCE, at ¶ B.1.6 (2003), *available at* http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf [hereinafter COMBINED CODE] (notice period of directors' service contracts should usually be no more than one year).

28. It is a fundamental principle that bidders must treat all shareholders of the same class of a target company similarly. TAKEOVER CODE, *supra* note 17, Gen. Principle 1, at B1. This principle is supplemented by a number of specific rules, including requirements that the offer price match the best price paid by the bidder for the target's shares during the three months before the offer, *id.*, Rule 6, at E11, that comparable offers must be made with all classes of equity share capital, *id.*, Rule 14, at H1, and that no "special deals with favourable conditions" be made with any shareholders, *id.*, Rule 16, at H3.

29. TAKEOVER CODE, *supra* note 17, Definitions, at C6 (defining "control" as "an interest, or interests, in shares carrying in aggregate 30% or more of the voting rights . . . of a company, irrespective of whether such interest or interests give de facto control").

30. TAKEOVER CODE, *supra* note 17, Rule 9, at F1.

31. *See* LEXISNEXIS BUTTERWORTHS, *supra* note 17, at 132–33.

32. *See* Erik Berglöf & Mike Burkart, *European Takeover Regulation*, 18 ECON. POL'Y 171, 196–98 (2003); D.D. Prentice, *Take-Over Bids and the System of Self-Regulation*, 1 OXFORD J. LEGAL STUD. 406, 409 (1981).

Table 1: M&A hostility in the United States and United Kingdom: 1990–2005[35]

	(1)	(2)	(3)	(4)	(5)
Location of target	**All M&A announced**	**Hostile**		**Hostile, completed**	
	#	#	% of (1)	#	% of (2)
US	54,849	312	0.57	75	24
UK	22,014	187	0.85	81	43

Source: Thomson Financial *SDC Platinum* database

permitted range of partial bids,[33] the mandatory bid rule chills some potential offers by forcing bidders to raise enough money to acquire the entire company, rather than just a controlling stake. However, this cost is likely to be at least matched by the benefit of guaranteed participation in any offer that is made.

The overall picture emerging, especially from the differences in the treatment of defensive tactics, is that U.S. takeover regulation seems significantly less shareholder-oriented than its U.K. counterpart. As *The Anatomy of Corporate Law*, a prominent recent book on comparative corporate law, put it, "[d]espite the commonality of the issue, the United Kingdom and the United States have made almost diametrically opposed choices" on how to regulate hostile takeovers.[34]

B. SO WHAT? (DO THE DIFFERENCES IN THE SUBSTANCE OF TAKEOVER REGULATION MATTER?)

What, though, should we make of these substantive differences? Is one approach superior to the other, or are the differences unimportant in the overall scheme of things?

The U.K. ban on defensive tactics by managers clearly makes it easier for hostile bids to succeed. Indeed, as Table 1 shows, an M&A transaction in the United Kingdom is more likely to be hostile, and if hostile, is more likely to

33. A partial bid in the United Kingdom requires the consent of the Takeover Panel, TAKEOVER CODE, *supra* note 17, Rule 36.1, at O1, although this will usually be granted if the bid would not result in the acquisition of more than 30% of the target's voting rights—that is, if it would not infringe the mandatory bid rule. *See* LEXISNEXIS BUTTERWORTHS, *supra* note 17, at 56.

34. Paul Davies & Klaus Hopt, *Control Transactions*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 157, 164 (Reinier Kraakman et al. eds., 2004).

35. Table 1 reports figures on M&A activity from 1990 to 2005 (inclusive) taken from Thomson Financial *SDC Platinum*, a subscription based service. Column (1) shows the total number of M&A transactions announced during this period for which the target was a publicly-traded firm located in the United States and United Kingdom, respectively. Columns (2) and (3) show the number, and percentage, respectively, of these transactions that were hostile. Column (4) shows the number of hostile transactions that were completed, and column (5) shows this as a percentage of the number of hostile transactions.

succeed, than in the United States. In both countries, hostility is the exception, rather than the rule, but in the United Kingdom, 0.85% of takeovers announced during the period 1990–2005 were hostile, compared with 0.57% in the United States. Of these hostile bids, 43% were successful in the United Kingdom, as opposed to just 24% in the United States. Evidence of a link between takeover defenses and takeover practice is buttressed by the fact that the rise of antitakeover mechanisms such as "poison pills" by U.S. firms in the 1990s coincided with a dramatic decline in levels of hostility in takeovers from the 1980s.[36] Those who view hostile takeovers as a disciplinary mechanism for managers therefore tend to prefer a regime like the Takeover Code that does not permit managers to use defensive tactics.[37] This gives boards a greater incentive to focus on returns to shareholders.

Takeovers are, of course, executed for a variety of reasons, of which the removal of underperforming managers is just one.[38] While some of these other reasons will tend to enhance social welfare—for example, the desire to exploit synergies through combination with the target firm—others are less benign. Some argue that many takeovers create wealth for stockholders only at the expense of other constituencies: most saliently, creditors and employees.[39] Takeovers may on occasion also be driven by "empire-building" by bidder managers, which would be unlikely to result in the creation of value for their shareholders.[40] If purely redistributional or value-decreasing motives predomi-

36. *See* Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, J. ECON. PERSP., Spring 2001, at 121, 126–27 & fig.6 (2001) (showing "the high level of hostility in the 1980s, especially as compared to the 1990s"); Omesh Kini, William Kracaw & Shehzad Mian, *The Nature of Discipline by Corporate Takeovers*, 59 J. FIN. 1511, 1514–15 (2004) (noting the characterization of 1980s takeovers as "marked by hostility" and contrasting "a less active and friendlier takeover market" of the 1990s).

37. *See, e.g.*, Lucian Ayre Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 978 (2002) (arguing against "board veto" and in favor of shareholder decisionmaking in takeovers); Ronald J. Gilson & Alan Schwartz, *Sales and Elections as Methods for Transferring Corporate Control*, 2 THEORETICAL INQUIRIES L. 783 (2001) (arguing that markets rather than elections should determine the outcomes of hostile takeover); Ronald J. Gilson, *Unocal Fifteen Years Later (And What We Can Do About It)*, 26 DEL. J. CORP. L. 491 (2001) (criticizing the Delaware Supreme Court for favoring shareholder elections to market-based decisionmaking in hostile takeover bids).

38. For a classic survey, see Roberta Romano, *A Guide to Takeovers: Theory, Evidence and Regulation*, 9 YALE J. ON REG. 119, 125–55 (1992).

39. Creditors, for example, may find the face value of their claims suddenly deflated by the target's having taken on a heavy debt burden to finance the acquisition or subsequent restructuring. *See* William W. Bratton, *Corporate Debt Relationships: Legal Theory in a Time of Restructuring*, 1989 DUKE L.J. 92, 137 (1989) (noting that acquisition of new debt often disadvantages bondholders); Morey McDaniel, *Bondholders and Corporate Governance*, 41 BUS. LAW. 413, 419 (1986) (same). Employees, who have made investments in firm-specific human capital on the faith of implicit promises of job security, may find themselves representing simply an operating cost to the bidder, and receiving their walking papers. *See* Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33, 36–38 (Alan J. Auerbach ed., 1988). In each case, a bid may be motivated by the desire to transfer wealth from these constituencies.

40. *See, e.g.*, Klaus Gugler, Dennis C. Mueller and B. Burçin Yurtoglu, *The Determinants of Merger Waves* (Wissenschaftszentrum, Berlin, Markets & Politics, Working Paper No. SP II 2006-01, 2006), *available at* http://ssrn.com/abstract=507282 (concluding that merger waves are driven primarily by

nate, then it may be desirable to restrict takeover activity.[41]

However, the empirical evidence on takeovers suggests that they generally create value. Empirical studies have consistently found that target shareholders experience significant positive returns from a takeover event.[42] In contrast, the empirical findings are more varied with respect to bidder shareholders: some studies report a small gain, others a small loss.[43] Yet even where losses accrue to bidder shareholders, these are considerably smaller than the gains to target shareholders, suggesting that on average such transactions create a significant amount of net value for shareholders.[44] Two recent studies, the first of which focuses particularly on the effects of hostile takeovers in the United Kingdom,[45] and the second of which employs a new empirical methodology,[46] both find stronger evidence of positive returns to acquirer shareholders as well. Moreover, studies that have explicitly examined claims of expropriation have concluded that the gains to shareholders greatly outweigh any costs incurred by other constituencies.[47]

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overvaluation of bidder shares permitting them to be used to fund acquisitions, and/or bidder management empire-building).

41. Takeovers might also be motivated by a desire to monopolize a market. Indeed, in the early 1900s, this was the predominant reason for mergers in the United States at a time when antitrust law stigmatized cartels but not mergers. However, in the presence of neutral antitrust regimes, such as those now existing on both sides of the Atlantic, concerns about competition need not form part of the debate about company law.

42. For U.S. studies, see, for example, Gregor Andrade, Mark Mitchell & Erik Stafford, *New Evidence and Perspectives on Mergers*, J. ECON. PERSP., Spring 2001, at 103, 110 (summarizing studies over period 1973–1998 and finding 23.3% abnormal return to target shareholders), Gregg A. Jarrell & Annette B. Poulson, *The Returns to Acquiring Firms in Tender Offers: Evidence from Three Decades*, FIN. MGMT., Autumn 1989, at 12, 16 (1963–1986: 28.9%), and Michael C. Jensen & Richard Ruback, *The Market for Corporate Control*: *The Scientific Evidence*, 11 J. FIN. ECON. 5, 10 & tbl.3 (1983) (1958–1981; 29.1%). For U.K. studies, see, for example, Julian R. Franks & Robert S. Harris, *Shareholder Wealth Effects of Corporate Takeovers: The U.K. Experience 1955–1985*, 23 J. FIN. ECON. 225, 232–33 & tbl.2 (1989) (1955–1985: 25.8%), Marc Goergen & Luc Renneboog, *Shareholder Wealth Effects of European Domestic and Cross-Border Takeover Bids*, 10 EUR. FIN. MGMT. 9, 23 & tbl.6 (2004) (1993–2000: 29.3%), and Robin J. Limmack, *Corporate Mergers and Shareholder Wealth Effects*, 21 ACCT. & BUS. RES. 239, 245 & tbl.3 (1991) (1977–1986: 33.0%).

43. For U.S. studies, see, for example, Andrade et al., *supra* note 42, at 110 & tbl.3 (1973–1998: −3.8% abnormal return for bidders), Jarrell & Poulson, *supra* note 42, at 16 (1963–1986: 1.96%), and Jensen & Ruback, *supra* note 42, at 16 (1958–1981: 3.8%). For U.K. studies, see, for example, Franks & Harris, *supra* note 42, at 232–33 & tbl.2 (1955–1985: 2.4%), Goergen & Renneboog, *supra* note 42, at 23 & tbl.6 (1993–2000: -1.65%), and Limmack, *supra* note 42, at 245 & tbl.3 (1977–1986: -2.6%).

44. *See* Andrade, Mitchell & Stafford, *supra* note 42, at 103.

45. Sudi Sudarsanam & Ashraf A. Mahate, *Are Friendly Acquisitions Too Bad for Shareholders and Managers? Long-Term Value Creation and Top Management Turnover in Hostile and Friendly Acquirers*, 17 BRIT. J. MGMT. S7, S17–S18 (2006) (examining sample of hostile and friendly U.K. acquisitions from 1983–1995 and finding hostile acquirers have significantly better subsequent performance than friendly acquirers).

46. Sanjai Bhagat et al., *Do Tender Offers Create Value? New Methods and Evidence* 34–36 (Dice Ctr., Working Paper No. 2004-4, 2004), *available at* http://ssrn.com/abstract=545642 (concluding that bidders "on average pay fair prices for targets").

47. *See, e.g.*, Gregg A. Jarrell, James A. Brickley & Jeffrey M. Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, J. ECON. PERSP., Winter 1988, at 49, 54–58 (1988).

Given the evidence that takeovers add value, and given the conflicts of interest that color target managers' response to a takeover bid, our provisional conclusion is therefore that the U.K. restrictions on defensive tactics seem preferable to the U.S. approach. Yet one puzzling finding remains. While hostile bids are less likely to succeed in the United States, the overall level of takeover activity, adjusted for the size of the economy, actually seems slightly higher than in the United Kingdom, even during the 1990s.[48] Might it be that, rather than deterring bidders altogether, the use of defensive measures in the United States has simply resulted in a change of tactics? Because a target board's consent is necessary to effect a takeover where an effective defense is in place, U.S. acquirers are now more likely to enter into negotiations with the target's board than to make a "hostile" offer directly to shareholders.[49]

Whether this is a good thing rather depends upon the target board's incentives. If their interests are well-aligned with those of shareholders, then the target board can be expected to negotiate a better price for the shareholders.[50] Thus where the directors are subject to other governance mechanisms which encourage them to work in shareholders' interests—most notably, appropriately designed compensation packages giving them a strong interest in the company's share price, and a preponderance of non-executive directors as overseers of the executives' decisions, then the shareholders may be more confident that this *ex post* power will be exercised in accordance with their interests.[51]

Does this mean that U.S. firms are able to "contract around" so as to achieve outcomes that are functionally equivalent to the United Kingdom?[52] For three reasons, we are skeptical of this claim.[53] First, a board veto will only work to

48. Based on data from the *SDC Platinum* database, in the period 1990–2002, 53.6% of firms listed in the United Kingdom were the target of a successful takeover, as compared with 65.6% in the United States. *See* Stefano Rossi & Paulo F. Volpin, *Cross-Country Determinants of Mergers and Acquisitions*, 74 J. FIN. ECON. 277, 281 (2004).

49. *See* G. William Schwert, *Hostility in Takeovers: In the Eyes of the Beholder?*, 55 J. FIN. 2599, 2638 (2000) (finding that "friendly" and "hostile" takeovers in the United States are economically indistinguishable and concluding that the difference is merely a matter of negotiating tactic).

50. Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, J. ECON. PERSP., Spring 2001, at 121, 132–37; Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 896–99 (2002); *cf.* Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L.J. 621, 683 (2003) (finding no empirical support for hypothesis that takeover defenses increase target bargaining power so as to promote higher price).

51. *See* Marcel Kahan & Edward B. Rock, *Corporate Constitutionalism: Antitakeover Charter Provisions as Precommitment*, 152 U. PA. L. REV. 473, 484–89 (2003); Thomas Moeller, *Let's Make a Deal! How Shareholder Control Impacts Merger Payoffs*, 76 J. FIN. ECON. 167, 186 (2005) (finding that where a staggered board structure has been adopted, a significantly larger premium is obtained for target shareholders if the board is controlled by independent directors).

52. The notion of "functional convergence" was popularized by Ron Gilson. *See generally* Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329 (2001).

53. We are also skeptical of recent suggestions in the literature that managers should be given discretion because information asymmetries or market inefficiencies make stock price a poor gauge of

shareholders' advantage in a takeover situation if the board is properly incentivized to act in shareholders' interests. In situations where the board does not have a sufficient stake in the firm, or is not adequately monitored by outside directors, board members may reject worthwhile takeover offers so as to retain their jobs—or accept inferior bids which are coupled with a "bribe" in the form of a handsome retirement package for the board.[54] A functional equivalence claim depends on the implausible assumption that managers, unconstrained by the threat of takeovers, will nevertheless agree to other measures that will render them accountable to shareholders.[55]

Secondly, the negative impact for shareholders of protecting the board from takeovers is not only felt at the time of a bid, but manifests itself most strongly in weaker incentives for managers at times when no bid is on the horizon. Because managers can effectively veto a bid, they have little need to fear that underperformance will at some point be "disciplined" by the market. Consistent with this, empirical studies report that the adoption of an antitakeover law has a negative impact on the stock prices of firms incorporated in that jurisdiction.[56] Similarly, firms that adopt effective antitakeover devices appear to produce inferior returns for shareholders.[57]

Finally, "incentivizing" the board with equity-based compensation, the principal alternative to direct shareholder choice, is no panacea; this can have perverse effects as well as beneficial ones.[58] The 1990s saw a staggering growth in the options-based pay granted to top U.S. executives at a pace that was internationally unique. This has been widely implicated in the "culture of greed" that led to the downfall of Enron, WorldCom and other leading corpora-

firm value. *See* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 545–60 (2002); Kihlstrom & Wachter, *supra* note 20, at 538–41. While the point is well taken that the presence of market inefficiencies casts doubt on strong prescriptions, we suspect that the benefits of managerial discretion are outweighed by managers' conflict of interest when a takeover bid is made.

54. *See* Moeller, *supra* note 51, at 179 (where outside directors do not control the board, a significantly smaller takeover premium is achieved); *see also* Subramanian, *supra* note 50, at 684 (concluding that "stock options and independent directors do not provide an adequate substitute for the hostile takeover threat as a disciplinary device" for managers).

55. Interestingly, one study shows that the introduction of state antitakeover laws in the late 1980s was associated with a *reduction* in the proportion of equity owned by managers incorporated in those jurisdictions—the opposite direction of change to that implied by functional equivalence. Shijun Cheng, *Identifying Control Motives in Managerial Ownership: Evidence from Antitakeover Legislation*, 18 REV. FIN. STUD. 637, 639 (2005).

56. Laurence Schumann, *State Regulation of Takeovers and Shareholder Wealth: The Case of New York's 1985 Takeover Statutes*, 19 RAND J. ECON. 557, 566 (1988) (introduction of antitakeover statutes in New York in the mid-1980s reduced the market value of firms incorporated in that jurisdiction).

57. *See* Paul A. Gompers, Joy L. Ishii & Andrew Metrick, *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107, 109 (2003); Lucian Bebchuk, Alma Cohen & Alan Ferrell, *What Matters in Corporate Governance?* (Harvard, John M. Olin Discussion Paper No. 491, 2005) (adoption of takeover defenses linked to inferior share price performance).

58. *See* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 205 (2004).

tions.[59] As became clear with the U.S. corporate scandals, heavily options-based pay gives managers an incentive to drive up the company's stock price in any way possible because managers profit if the price rises but aren't punished if it falls.[60]

To summarize: in our view, the U.K. system renders managers more directly accountable to shareholders. While it is possible for U.S. firms to contract around its more manager-friendly regime, the costs of doing so seem to be very high. Thus, the differences in the substance of takeover regulation seem to lead to real differences in takeover practice.

C. THE DIVERGENT MODES OF REGULATION

Shifting now to the mode of takeover regulation, we find differences that are even more striking than those relating to the substance of the two nations' rules. Once again, we begin with the United States.

U.S. takeover regulation is the domain of courts and regulators. The tender offer itself is regulated principally by the Securities and Exchange Commission, which assesses compliance with the disclosure and process rules. Managers' response to a takeover bid, by contrast, is regulated primarily by state courts—which usually means Delaware's Chancery judges and Supreme Court. When a takeover bidder believes that the target's managers are improperly stymieing its bid, the bidder generally files suit in the Delaware Chancery Court. The suit argues that the target managers have breached their fiduciary duties—that the managers' resistance is beyond the pale—and that the managers should be forced to remove their defenses so that the takeover can be considered by the target's shareholders.[61]

The key players in the drama are lawyers and judges. Each of the relevant parties is advised by lawyers, and contested takeover battles nearly always make their way to the courts. In Delaware, the nation's most sophisticated and efficient corporate law arbiter, this may mean a week or two, and sometimes substantially longer, in the Chancery Court. To give just one example, the battle by Oracle to take over PeopleSoft required a trial that unfolded over a period of several weeks. All the while the parties bargained—as Vice Chancellor Leo Strine has put it in a related context, with a bit of exaggeration about his own

59. *See* JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 62–64 (2006); DAVID SKEEL, ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM 152–54 (2005); William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1359 (2002).

60. *See, e.g.*, SKEEL, *supra* note 59, at 154 (describing the effect of options on managers' incentives); Kees Cools, *Ebbers Rex*, WALL ST. J., March 22, 2005, at B2 (reporting empirical results suggesting that the best predictors of the likelihood a company would become involved in a corporate scandal were the extent of options-based compensation and earnings targets).

61. Once the bidder files suit, other target shareholders often file "piggyback" litigation. The Delaware courts usually address the various suits together.

appearance—"in the glare of the vice chancellor's bald head."[62] The PeopleSoft battle finally ended when PeopleSoft's managers agreed to the takeover, which obviated the need for either a written opinion or an appeal to the Delaware Supreme Court. But many of the most hotly contested takeover issues are finally resolved after another round of lawyers' arguments in the Supreme Court.

Turn to the United Kingdom and the lawyers miraculously disappear.[63] When a hostile bidder launches a takeover effort and believes that the target's managers are interfering with the bid, the bidder lodges a protest with the Takeover Panel. Originally housed in the Bank of England, the Takeover Panel is now located in the London Stock Exchange building. The Takeover Panel—which includes representatives from the Stock Exchange, the Bank of England, the major merchant banks, and institutional investors—administers a set of rules known as the City Code on Takeovers and Mergers.[64] Both the Panel and the Code were, until very recently, entirely self-regulatory. Although, as part of the United Kingdom's implementation of the European Union's Takeover Directive, they have now been given a statutory underpinning, this has been designed with the express objective of maintaining the characteristic features of the Panel's approach, which are based on self-regulation.

Takeover Panel oversight differs from the U.S. framework for regulating takeovers in at least three important respects. First, the Takeover Panel addresses takeover issues in real time, imposing little or no delay on the takeover effort. In the context of an active bid, the Panel's Executive requires participants to give it regular updates on compliance. Faced with a protest by one of the parties, it will issue rulings as appropriate. It might, for example, require that a target board remove its interference with a bid, or instruct the bidder to provide

62. Email from Leo Strine, Vice Chancellor, Delaware Court of Chancery, to David A. Skeel, Jr. (Dec. 16, 2004) (on file with authors).

63. *See* Lord Alexander of Weedon Q.C., *Takeovers: The Regulatory Scene*, J. BUS. L. 203, 213–14 (1990) (discussing a case in which the U.K. Court of Appeal expressly declared its hesitancy to intervene on a decision by the U.K. Takeover Panel); Edward Baker & Selina Sagayam, *The UK Takeover Regime—The Way it Works, Why it Works and What Lies Ahead Under the Takeover Directive*, 10 ONDERNEMINGSRECHT 384, 385 (2004) (noting "a marked absence of litigation in the conduct of UK takeovers"); T. Peter Lee, *Takeover Regulation in the United Kingdom*, *in* EUROPEAN TAKEOVERS: LAW AND PRACTICE 133, 133 (Klaus Hopt & Eddy Wymeersch eds., 1992) (explaining that a "system of voluntary self-regulation" controls U.K. takeovers and that "[s]elf-regulation is a system whereby the bodies who control, police and regulate the market do not draw any authority from the law"); Geoffrey Morse, *Controlling Takeovers—The Self Regulation Option in the United Kingdom*, J. BUS. L. 58, 60–61 (1998) (noting that U.K. takeover law "is not devised by or for the benefit of lawyers"). *See generally* Takis Tridimis, *Self-Regulation and Investor Protection in the United Kingdom: The Takeover Panel and the Market for Corporate Control*, 10 CIV. JUST. Q. 24, 25–27 (1991) (explaining that U.K. takeovers are self-regulated and that the Takeover Panel "avoids the formalities of legal proceedings").

64. *See generally* sources cited *supra* note 17. Since May 20, 2006, both the Takeover Panel and the City Code have been given a legal underpinning as part of the United Kingdom's implementation of the European Union's Takeover Directive (discussed *infra*, text accompanying notes 283–294). However, the implementation has been carried out with the express objective of maintaining all the characteristic features of the Panel's functions discussed in the text. Hence the Code retains most of the characteristics of "soft law," even if this description is technically now outdated.

additional disclosure, or decline to take any action at all.[65] To be sure, the Delaware courts provide an extraordinarily prompt response to takeover challenges, often deciding the case as soon as the parties have completed their oral arguments. But the overall process usually takes weeks and sometimes months. The informality of the Takeover Panel, by contrast, enables it to respond almost immediately. In the words of one historian:

> The reputation of the Panel in the City depends considerably on the efficiency of the Panel executive in dealing promptly, fairly and decisively with the large number of queries that pour into the office every day. . . . If the point is a difficult one, the Panel executive may ask for time to consider, but this is thought of in terms of hours rather than days.[66]

Second, the flexibility of the Panel's approach means that it is able to adjust its regulatory responses both to the particular parties before it, and to the changing dynamics of business within the City of London. Takeover participants are expected to comply with the "spirit" as well as the letter of the Code, on which they are expected to seek guidance from the Panel. Because they are actively engaged with the parties, the Panel's Executive are able to tailor the regulatory requirements (outlining compliance conditions or waiving rules, as appropriate) to the circumstances of a particular case. Moreover, the Panel's Code Committee is charged with regular and proactive updating of the Code's provisions to reflect changes in the marketplace.

Finally, as already noted, lawyers play relatively little role in Takeover Panel oversight. The Panel's members come from the principal shareholder and financial groups, and the staff consists primarily of business and financial experts, rather than lawyers, due to a conscious decision from the beginning "that the Panel executive should for the most part be staffed by temporary secondments from City firms."[67] The Takeover Panel is thus oriented around business, rather than the law. The culture could hardly be more different than the lawyers-with-briefcases approach that characterizes American takeover regulation.

D. SO WHAT? (AGAIN): DO THE DIFFERENCES IN THE *MODE* OF TAKEOVER REGULATION MATTER?

With the substantive differences between the U.S. and U.K. approaches, we were somewhat agnostic as to whether one approach is preferable to the other. With the mode, or process, we have far less ambivalence: we consider that the U.K.'s system has clear advantages.

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65. A party unhappy with a ruling from the Panel's Executive could appeal to the Panel's Hearings Committee.

66. SIR ALEXANDER JOHNSTON, THE CITY TAKE-OVER CODE 125 (1980).

67. *Id.* at 127.

Consider first, speed. The Takeover Code prescribes a clear timetable for the conduct of bids in order to minimize the amount of time for which the uncertainty of a takeover battle may surround the target company.[68] This is reflected both in the Code itself and in the Panel's practice throughout the bidding process. Thus a bidder that has expressed a firm intention to make an offer must usually follow this with a formal offer within twenty-eight days.[69] A formal offer, once made, may not usually remain open for more than sixty days unless it has been declared unconditional as to acceptances,[70] and all other conditions must be fulfilled within twenty-one days from that point.[71] Moreover, an unsuccessful bidder may not normally make another offer for the same target within twelve months.[72]

Consistent with this goal of resolving bidding situations quickly and with minimum uncertainty, tactical litigation is usually ruled out. The Panel will normally prohibit the target board from commencing legal action which might have the effect of frustrating a bid, regardless of the perceived merits of the claim in question, unless shareholder consent has been obtained.[73] The Panel's decisions have themselves been held to be subject to judicial review.[74] However, the English Court of Appeal, determined not to allow judicial review to become a tactic for interfering with the Panel's "real-time" decision making,

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68. TAKEOVER CODE, *supra* note 17, Rules 30–35, at M1–N3. Deviations from the timetable may be permitted by the Takeover Panel in particular cases.

69. *Id.*, Rule 30.1, at M1. If a party announces that it is considering making a bid, the potential target may ask the Panel to issue a so-called "put up or shut up" notice to the potential bidder to resolve the uncertainty—that is, to clarify publicly whether it will be making a bid. *Id.*, Rule 2.4(b), at D5; *see also* CODE COMM., THE PANEL ON TAKEOVERS AND MERGERS, "PUT UP OR SHUT UP" AND NO INTENTION TO BID STATEMENTS: REVISION PROPOSALS RELATING TO RULES 2.4, 2.8 AND 35.1 OF THE TAKEOVER CODE pts. 1&2 (2004) (U.K.), http://www.thetakeoverpanel.org.uk/new/consultation/DATA/PCP200401.pdf.

70. TAKEOVER CODE, *supra* note 17, Rule 31.6, at M5–6. The announcement of a second bid will reset the timetable for the first bidder in order to give it time to respond by raising its price. However, where a competitive bidding situation has not been resolved within forty-six days of the second offer, the parties must move to an accelerated open auction procedure. *Id.*, Rule 32.5, at M12; *see also* CODE COMM., THE PANEL ON TAKEOVERS AND MERGERS, RESOLUTION OF COMPETITIVE SITUATIONS: REVISION PROPOSALS RELATING TO RULES 31.6, 32, AND 35 OF THE TAKEOVER CODE pt. 1.1 (2001) (U.K.), http://www.thetakeoverpanel.org.uk/new/consultation/DATA/PCP7.pdf).

71. TAKEOVER CODE, *supra* note 17, Rule 31.7, at M7.

72. *Id.*, Rule 35.1, at N1.

73. THE PANEL ON TAKEOVERS AND MERGERS, PANEL STATEMENT 1989/7: CONSOLIDATED GOLD FIELDS PLC 2 (1989) (U.K.), http://www.thetakeoverpanel.org.uk/new/statements/DATA/1989/1989-07.pdf (panel ruling forbidding Consolidated Gold Fields from taking legal action against a potential acquirer unless "the directors obtain shareholders' approval"); WEINBERG & BLANK, *supra* note 17, §§ 4-7114 to 4-7126. In deference to the overriding public importance perceived to attach to antitrust concerns, a more lenient approach is taken with regard to references to competition authorities by the target. An initial reference, at least, would be unlikely to be considered to breach the Code. *See* THE PANEL ON TAKEOVERS AND MERGERS, PANEL STATEMENT 1989/20: B.A.T. INDUSTRIES PLC 10–14 (1989) (U.K.), http://www.thetakeoverpanel.org.uk/new/statements/DATA/1989/1989-20.pdf. Bidders have responded to the risk that this poses to offers by seeking clearance, where antitrust concerns are material, in advance of making a firm offer. If clearance is given, then a tactical appeal by the target against the competition authority's decision would be likely to be viewed as "frustrating action" by the Panel. *See* LEXISNEXIS BUTTERWORTHS, *supra* note 17, at 679–80).

74. R. v. Panel on Take-Overs and Mergers, [1987] Q.B. 815.

made clear that relief, if ever granted, would only be declaratory regarding future conduct and would not have any consequences for the validity of decisions which have been made.[75]

In the United States, there are no such restrictions on how long an offer may remain open, or indeed, on repeated bids for the same target. Furthermore, resort to litigation is a defensive tactic frequently employed by target boards. When Oracle launched its highly publicized bid for PeopleSoft in 2003, for instance, PeopleSoft's first response was to sue, accusing Oracle of "deceptive business practices, tortious interference, and a litany of other misdeeds."[76] PeopleSoft then began an intense, successful campaign to persuade the U.S. Department of Justice to challenge the proposed acquisition on antitrust grounds.[77] Only eighteen months later, after the government's antitrust challenge had been rejected, did Oracle finally prevail.[78] In part because of target managers' ability to use defenses and stalling tactics, a typical M&A deal in the United States takes approximately five months to complete,[79] and the period is usually considerably longer for hostile acquisitions.[80]

Now consider costs. Litigation is an expensive way of resolving disputes. Table 2 shows that approximately one-third of hostile takeovers in the United States are litigated. In contrast, hostile bids are almost never litigated in the United Kingdom, where a significant proportion of the regulatory issues are resolved by no more than a telephone call to the Panel Executive. In contrast to the services of litigation lawyers, the Panel does not charge for the issuance of such guidance. Rather, its operations are funded by a fee charged in relation to formal offers,[81] a small levy paid on significant dealings in shares on the

75. *Id.* at 841–42.

76. David Millstone & Guhan Subramanian, Oracle v. PeopleSoft*: A Case Study*, 12 HARV. NEGOT. L. REV. (forthcoming 2007) (manuscript at 7, *available at* http://ssrn.com/abstract_id=816006).

77. *Id.* at 11 (describing the campaign).

78. *See, e.g.*, *id.* at 7, 16, 22. PeopleSoft finally gave in at the end of a multi-week trial in the Delaware Chancery Court to address Oracle's claims that the PeopleSoft directors' defensive tactics violated their fiduciary duties. For a colorful diary of the trial, see David Marcus, *The Trial: Two Weeks in Delaware with Leo Strine, Larry Ellison, Craig Conway and Lots of Arbs on Cell Phones*, THE DEAL, Nov. 1, 2004. For a defense of PeopleSoft's post-bid defensive tactics, arguing that the PeopleSoft directors preserved the viability of the company, see Jennifer Arlen, *Regulating Post-Bid Embedded Defenses: Lessons from Oracle Versus PeopleSoft*, 12 HARV. NEGOT. L. REV. 71 (2007).

79. See David A. Becher & Jennifer L. Juergens, Analyst Recommendations and Mergers: Do Analysts Matter? 34 (May 2005) (unpublished manuscript, *available at* http://www.fma.org/Siena/Papers?150090.pdf) (Table 1 demonstrates that the average time to completion for a sample of U.S. M&A deals during the period 1993–2000 was 146 days).

80. William C. Hunter & Julapa Jagtiani, *An Analysis of Advisor Choice, Fees, and Efforts in Mergers and Acquisitions*, 12 REV. FIN. ECON. 65, 74–76 & tbl.6 (2003) (reporting results for sample of M&A deals during 1995–2000 and concluding that hostile tender offers typically take longer to complete than friendly deals).

81. A "document charge" is levied by the Panel on the issue of formal offer documentation in relation to offers exceeding £1 million in value. It is set at a declining marginal rate, starting at 0.2% of the value of an offer over £1 million, and falling to below 0.02% of the value of offers over £1 billion. *See* TAKEOVER CODE, *supra* note 17, Document Charges, at Document 1.

Table 2: M&A litigation in the United States and United Kingdom: 1990–2005[84]

	(1)	(2)	(3)
Location of target	Hostile	Hostile, litigated	
	#	#	%
U.S.	312	106	33.9%
U.K.	187	2	0.1%

Source: Thomson Financial *SDC Platinum* database

London Stock Exchange,[82] and by sales of the Takeover Code.[83]

Given the differences in litigation rates, we would expect U.S. lawyers to make more money from M&A transactions than their U.K. counterparts. Whilst lawyers in both jurisdictions would advise on the transactions themselves, U.S. lawyers also advise on takeover litigation, which simply does not occur in the United Kingdom. To our knowledge, no direct evidence currently exists on the comparative level of legal advisor fees incurred in the two jurisdictions.[85] However, as Table 3 shows, leading U.S. firms with an M&A oriented practice generate significantly more revenue per lawyer and profit per partner than do their U.K. counterparts. While of course law firms' financial performances are affected by a wide range of factors, these figures are not inconsistent with the conclusion that the U.S. system is considerably more expensive for parties to a takeover.[86] Diversified shareholders, who stand to participate equally on the winning and losing sides of transactions would, however, surely prefer a cheaper system of regulating takeovers.

The differences between the two systems extend beyond the resolution of individual takeover situations. Perhaps even more significant are the dynamic effects—that is, the way in which the two regulatory regimes change over time. The United Kingdom's regulatory regime is proactive in its response to market

82. The levy is £1 on any purchase or sale of shares in excess of £10,000. *See* London Stock Exchange Notice N07/02: Panel on Takeovers and Mergers—PTM Levy (March 7, 2002), http://www.londonstockexchange.com/nr/rdonlyres/1E76d001-184a-4745-953b-d778e7192cff/0/n0702.pdf.

83. *See, e.g.*, THE PANEL ON TAKEOVER AND MERGERS, REPORT AND ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005, at 16 (2006) (U.K.), http://www.thetakeoverpanel.org.uk/new/reports/DATA//Report2005.pdf.

84. Table 2 reports figures on M&A litigation from 1990 to 2005 (inclusive) taken from Thomson Financial *SDC Platinum* database, a subscription service. Column (1) shows the total number of hostile M&A transactions announced during this period for which the target was a publicly-traded firm located in the United States and United Kingdom, respectively. Columns (2) and (3) show the number, and percentage, respectively, of these transactions for which "litigation" or "litigation delay" is recorded as an aspect of the deal.

85. None of the major M&A databases (Mergermarket, Bloomberg and Thomson *SDC Platinum*) contain records of legal advisor fees for a meaningful number of transactions.

86. In a litigation-oriented system, lawyers may be expected to generate greater fees not only in cases that are actually litigated, but in any case where litigation is a threat.

Table 3: Financial performance of leading M&A law firms, 2004–2005[87]

U.S. Firms	Profits per equity partner/ $k	Revenue per lawyer/ $k	U.K. Firms	Profits per equity partner/ $k	Revenue per lawyer/ $k
Wachtell, Lipton	3,790	2,395	Slaughter and May	1,951	936
Sullivan & Cromwell	2,410	1,625	Linklaters	1,565	743
Cravath	2,600	1,280	Freshfields	1,300	685
Davis Polk	2,000	1,145	Clifford Chance	1,209	685
Simpson Thacher	2,370	1,125	Herbert Smith	1,501	616

Sources: *AmLaw 100* (www.americanlawyer.com); *The Lawyer* Global 100 (www.thelawyer.com)

developments. The Code Committee of the Takeover Panel meets several times a year to discuss the operation of the market, assess recent developments and determine whether any amendments to the Takeover Code are necessary.[88] In contrast, U.S. courts make rules in a way that is essentially reactive: changes in the marketplace lead to litigation, following which, the courts pronounce upon acceptable behavior.

The Delaware courts have adapted the traditional litigation process to counteract its limitations in several important respects. First, Delaware's generosity in awarding attorney's fees to the lawyers for shareholder plaintiffs assures a steady stream of cases to the Delaware courts. Moreover, even when it concludes that the directors did not breach their duties, the chancery court often critiques the directors' performance, offering guidance to directors who will be dealing with similar issues in the future.[89] Finally, the five Delaware Chancery judges frequently compare notes, often over lunch, about emerging corporate law issues, which enables them to begin mulling over new developments long before a particular dispute arises. Despite these remarkable adaptations, how-

87. Exchange rate used: US$1.00 = GB£0.538. This was averaged over the period July 1, 2004 to June 30, 2005. OANDA.com: The Currency Site, FXHistory: Historical Currency Exchange Rates, http://www.oanda.com/convert/fxhistory (last visited March 23, 2007).

88. For example, the Code Committee met seven times in 2005–2006, THE PANEL ON TAKEOVER AND MERGERS, REPORT AND ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006, at 11 (2006), http://www.thetakeoverpanel.org.uk/new/reports/DATA//Report2006.pdf, and eight times in 2004–2005, THE PANEL ON TAKEOVER AND MERGERS, REPORT AND ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005, at 10 (2005), http://www.thetakeoverpanel.org.uk/new/reports/DATA//Report2005.pdf.

89. These attributes of the Delaware courts are explored in detail in Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1098–99 (1997).

ever, it remains true that the Delaware courts cannot take action until an actual controversy arises.

An issue that has recently led to controversy in takeover disputes on both sides of the Atlantic provides a simple case study of the process differences we have just described. In a number of recent takeover disputes, bidders have sought to acquire or influence control of a target without triggering disclosure obligations by using derivatives. A good example are "contracts for differences" or "CFDs" (known as "equity swaps" in the United States), bilateral contracts under which the holder essentially takes a bet against a financial institution counterparty on the price of an underlying security. As part of its hedging strategy for a long CFD,[90] the counterparty will typically acquire the underlying security, which can then be transferred to the purchaser in settlement of a long position. Because it is fully hedged, the counterparty has no financial interest in the underlying security, but nevertheless holds the voting rights, which it may be persuaded to exercise in accordance with the wishes of the CFD holder.[91] Through this arrangement, the CFD holder may be in a position to exercise voting control of the underlying shares without having any beneficial interest in them. Such arrangements were in several recent instances used to assist bidders in acquiring control of targets without triggering disclosure obligations.[92]

In the United States, a similar strategy achieved notoriety in 2005 in connection with a proposed acquisition by Mylan, a pharmaceutical company, of King, another pharmaceutical. Perry Corp., a hedge fund that held a substantial stake in King, bought and simultaneously hedged 9.9% of Mylan's stock.[93] In effect, Perry bought 9.9% of the Mylan votes, in an effort to tip the Mylan vote in favor of the acquisition so that it could profit from acquisition of its King shares. Perry's gambit (later abandoned after Carl Icahn, another Mylan stockholder, sued) brought the new vote buying technique and the potential for abuse to public attention.

The Takeover Panel's response to similar issues in the United Kingdom was,

90. For a long CFD, the holder bets on a rise in price of the underlying security; for a short CFD, on a fall. *See* CODE COMM., THE PANEL ON TAKEOVER AND MERGERS, DEALINGS IN DERIVATIVES AND OPTIONS: OUTLINE PROPOSALS RELATING TO AMENDMENTS PROPOSED TO BE MADE TO THE TAKEOVER CODE AND THE SARS 4–5 (2005) [hereinafter TAKEOVER PANEL, DERIVATIVES AND OPTIONS].

91. *Id.*

92. For example, when BAE Systems plc made an offer for Alvis plc in 2004, BAe was able to obtain irrevocable commitments to accept its offer in respect of 16% of Alvis's share capital, through obtaining promises from counterparties to long CFDs it had entered into in respect of Alvis's shares. *Id.* at 6.

93. The Perry episode is described and criticized in David Skeel, *Behind the Hedge*, LEGAL AFF., Nov.–Dec. 2005, at 28, 29–30 (emphasizing that Perry's economic incentives were diametrically opposed to the interests of other Mylan shareholders—the more overpriced the acquisition, the more Perry would have profited due to its stake in King). For thoughtful and extensive analysis of the new vote buying techniques, see generally Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control* (Univ. of Pa., Inst. for Law & Econ. Research Paper No. 06-16, 2006), *available at* http://ssrn.com/abstract=919881.

after consultation in 2005, to amend the Takeover Code in May 2006 so as to equalize the disclosure treatment of long CFDs and similar derivative contracts with that of the underlying securities.[94] In the United States, by contrast, the response has been much slower. There are hints of activity at the SEC, but it probably lacks authority, without a Congressional amendment to the securities laws, to promulgate a substantive rule aimed at the new vote buying.[95] Nor is there any evidence that the Delaware courts will intervene anytime soon.[96]

In summary, the U.S. approach gives target managers discretion to defend a bid, whereas the United Kingdom gives the decision to shareholders. The principal decision makers in the United States are Congress and the Delaware courts. In the United Kingdom, by contrast, informal regulation by the Takeover Panel takes center stage. While neither approach is clearly superior substantively, the U.K. process seems quicker, cheaper, and more proactive in response to market developments.

II. THE HISTORICAL DIVERGENCE: A BRIEF CHRONOLOGICAL TOUR

The deep divergences in United States and United Kingdom takeover regulation are surprising on several different levels. After all, when it comes to business and finance, the United States and the United Kingdom arguably have more in common than any other pair of developed economies. Corporate governance is market-oriented in each country, and the largest corporations are characterized by a separation of ownership and control that is uncommon elsewhere in the world. The legal system in each country has a common law orientation, unlike the civil law approach that characterizes many other countries. Yet, despite all of these similarities, the United States and United Kingdom use very different strategies for regulating takeovers, the most prominent issue in all of corporate law.

Why did the two nations take such divergent courses? To answer this question, we must delve into the political and historical evolution of the two approaches.

A. WHAT HAPPENED IN THE UNITED STATES?

Although U.S. takeover regulation is often associated with a cluster of Delaware takeover cases in the 1980s, the foundations were laid much earlier. For present purposes, the key events were a series of New Deal banking and securities law reforms in the 1930s. Their effects were reinforced three decades

94. *See* TAKEOVER PANEL, DERIVATIVES AND OPTIONS, *supra* note 90; TAKEOVER CODE, *supra* note 17, Definitions, at C11–12 n.9.

95. The SEC could, however, use its existing authority to require more disclosure of derivatives-based vote buying. For a proposed disclosure framework that would achieve this effect, see Hu & Black, *supra* note 93, at 15–18. Disclosure-based regulation seems likely to be the principal U.S. regulatory response, but the SEC had not even begun the rulemaking process as of this writing.

96. *See, e.g.*, Skeel, *supra* note 93, at 32 (noting that Perry's vote buying does not appear to violate the Delaware prohibition against vote buying because Perry did not directly purchase votes).

later, after the emergence of hostile tender offers, by Delaware's 1967 corporate law reforms and the Williams Act amendments to the securities laws passed by Congress the following year. These legislative developments foreclosed other regulatory options, leaving takeover regulation to the Delaware courts.

The 1933 and 1934 securities acts were passed in the wake of the 1929 Crash and the early years of the Depression, and sought to correct the perceived market abuses of the 1920s by imposing new disclosure and antifraud regulation.[97] The 1934 Act also established the Securities and Exchange Commission to serve as the principal policeman of the markets. During this same period at the outset of Franklin D. Roosevelt's presidency, Congress also enacted major banking regulation that separated commercial and investment banking (the Glass-Steagall Act), and established deposit insurance to protect Americans' savings (Glass-Steagall, together with the Banking Act of 1935).[98]

With a strong populist wind at its back, the New Deal Congress quite explicitly sought to restructure American business and finance through these reforms. The banking reforms helped to cement the existing fragmented nature of U.S. banking, thereby restraining banks from becoming significant players in the governance of America's largest corporations.[99] The creation of the SEC, and the SEC's authority to oversee the stock exchanges, then put a governmental regulator in the oversight role that had previously been occupied by the banks and other Wall Street insiders. Many of Roosevelt's corporate law advisors wanted to go still further and enact a federal incorporation statute that would make Congress, rather than the states, the principal regulator of corporate law.[100] But the campaign for federal incorporation foundered, in part because of missteps in the timing and framing of the legislation.[101]

Takeovers didn't enter the picture in any significant way for another twenty years. The first hint of a change came in 1954, when Robert Young launched a hotly contested and ultimately successful proxy contest for control of the New York Central Railroad. The Young proxy contest was viewed as an assault on

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97. Like nearly all of America's most important federal corporate regulation, the securities acts were passed in the aftermath of major corporate scandals. For a historical analysis of the enactment of the securities laws, together with the New Deal restructuring of the banking and utilities industries briefly described below, see, for example, SKEEL, *supra* note 59, at 75–106.

98. The Glass-Steagall Act of 1933, which separated commercial and investment banking, lasted until 1999, when it was largely repealed. Glass-Steagall Act of 1933, ch. 89, 48 Stat. 162 (codified at 12 U.S.C. § 377), *repealed by* Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, § 101(a), 113 Stat. 1338, 1341 (1999).

99. *See* ROE, *supra* note 6, at 28–32, 94–101.

100. In a letter to Adolf Berle, William Douglas, who would later serve as SEC chair and then Supreme Court Justice, vowed that "you can count on me to pull an oar on federal incorporation." Letter from William O. Douglas to Adolph Berle (January 3, 1934) (on file with the Library of Congress, Douglas Papers, Container No. 2).

101. Federal incorporation was not pursued until the late 1930s, and it was packaged with an unpopular antitrust bill. For a discussion of the missteps that doomed the proposal, see JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 208–10 (1982).

existing norms of Wall Street behavior, which discouraged public challenges to corporate directors.[102] Although Young's campaign was a spectacular success, and the 1950s also saw several other prominent battles,[103] proxy contests were an unwieldy and usually ineffective mechanism for obtaining control, since the success depended on the bidder's powers of persuasion and the extent of dissatisfaction among the company's shareholders. In the late 1950s and early 1960s, corporate raiders devised a more powerful strategy, the tender offer. Tender offers were far more effective than the traditional proxy contest because the bidder offered cold hard cash, rather than simply a plea for the target shareholders' vote in a directorial election.

Hostile tender offers became increasingly common in the 1960s, rising from seventy-nine from 1956–1960 to nearly twice that number from 1964–1966.[104] Although a prescient 1965 article by Henry Manne stoutly defended the governance benefits of takeovers, in most quarters they were deeply controversial.[105] The premier Wall Street investment banks and law firms refused to represent bidders in a hostile takeover. "Taking their cues from longtime business clients," as one law firm historian puts it, "the older [law] firms considered takeovers unsavory."[106] This left the practice to scrappy upstarts like Joseph Flom of the law firm now known as Skadden, who became the leading takeover lawyer by taking cases the white shoe firms refused to touch.[107]

As takeovers and other merger and acquisition activity intensified, lawmakers passed important reforms in the late 1960s. The first was the 1967 amendments to Delaware's General Corporation Law. Based on the recommendations of a "revision committee" commissioned in 1967, Delaware passed its most sweeping corporate law reforms since the end of the nineteenth century.[108] Among the key changes made by the 1967 amendments were a sharp expansion of the powers of a corporation to indemnify its directors, an attempted codification of the standard for reviewing self-interested transactions, a provision authorizing

102. The Young contest and its implications for American corporate governance and finance are discussed in RON CHERNOW, THE HOUSE OF MORGAN: AN AMERICAN BANKING DYNASTY AND THE RISE OF MODERN FINANCE 508–11 (1990).

103. For a contemporary review of a book chronicling the New York Central fight and eight other "spectacular proxy battles that have shaken American enterprise during the past decade," including a control battle over Montgomery Ward, see Anthony Arau, *Wanted: Proxies*, N.Y. TIMES, Nov. 25, 1956, at 308 (reviewing DAVID KARR, FIGHT FOR CONTROL (1956)).

104. *See* Note, *Cash Tender Offers*, 83 HARV. L. REV. 377, 377 n.1 (1969).

105. Henry Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112–13 (1965).

106. LINCOLN CAPLAN, SKADDEN: POWER, MONEY, AND THE RISE OF A LEGAL EMPIRE 52 (1993); *see also id.* at 54 (describing Davis Polk's refusal to represent bidders that made hostile bids).

107. *See id.* at 40, 52.

108. The template for Delaware corporate law was its 1899 Act, which had been patterned on New Jersey's corporate law statute of 1896, *see* Act of April 21, 1896, ch. 185, 1896 N.J. Laws 277. *See* William E. Kirk, III, *A Case Study in Legislative Opportunism: How Delaware Used the Federal-State System to Attain Corporate Pre-Eminence*, 10 J. CORP. L. 233, 252–53 (1984).

cashout mergers, and a reduction of the availability of appraisal rights.[109] Although none of the major changes were directly aimed at the surge in hostile takeover bids, the reforms were designed to address concerns that had frequently been raised by managers. Expanded indemnification provided more protection against the possibility of fiduciary duty litigation, and retrenchment on appraisal rights smoothed the skids for large corporations that had embarked on acquisition campaigns.

More important than the details was the overall effect of the reforms. By the early 1960s, Delaware's pre-eminence as the leading state of incorporation had started to fade. The 1967 reforms spurred a dramatic increase in incorporations and reincorporations.[110] By the 1980s, when the biggest judicial challenges to hostile takeovers began, nearly all of the most important cases would make their way through the Delaware courts.

The ground rules that defined how the 1980s takeover bids were structured were put in place by the other major 1960s reform, the Williams Act. In its original incarnation, as introduced by New Jersey Senator Harrison Williams in 1965, the bill would have made it unlawful for a bidder to acquire more than 5% of a target company's stock "until the expiration of twenty days after such person has sent to the [target company] . . . and has filed with the [SEC] a statement" describing, among other things, "the background and identity of all persons" making the bid, the source of the bidder's funds, and the dates and prices at which the bidder had previously purchased stock.[111] In effect, the original bill would have required bidders to give twenty days notice to the target company, so that the target had plenty of time to get its defenses ready. Over the next several years, the SEC worked with Senator Williams and the Senate Committee on Banking and Currency to refine the bill. At the principal hearing held on the proposed legislation, a parade of witnesses questioned the proposal for prior disclosure, while mostly agreeing with recommendations to require bidders to pay the same amount to all tendering shareholders and giving shareholders the right to withdraw their tender for a period of time.[112]

As enacted in 1968, the Williams Act requires disclosure by any party making a tender offer that would give it more than five percent of the target's stock; gives shareholders the right to withdraw stock they had initially tendered to the bidder for the first seven days of the offer; requires a bidder to purchase stock

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109. The changes are described in detail in S. Samuel Arsht & Walter K. Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 77–82, 85–90 (1967).

110. *See, e.g.*, William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism* 20–21 (European Corp. Governance Inst. Law Working Paper Series, Working Paper No. 23/2004 & Georgetown Univ. Law Ctr. Bus., Econ. & Regulatory Policy, Research Paper No. 606481, 2004), *available at* http://ssrn.com/abstract=606481 (noting that Delaware's revenues from chartering had dropped to 7% of its total revenues by 1963, but that its share of the market for incorporations has steadily increased since the 1967 amendments).

111. A Bill Providing for Fuller Disclosure of Corporate Equity Ownership of Securities Under the Securities Exchange Act of 1934, S. 2731, 89th Cong. §2 (Oct. 22, 1965).

112. The testimony is recounted in more detail *infra* Part III.C.

on a pro rata basis, rather than purchasing first from the shareholders who tender first; requires the bidder who raises its bid price to pay the higher price even to shareholders who tendered at the lower price; requires that the offer be kept open at least forty days; and prohibits fraud by either side in a tender offer campaign.[113] The overall objective of the new rules was to prevent bidders from conducting so-called "Saturday night special" tender offers—offers that put pressure on shareholders to tender by requiring a rapid decision and making the offer available on a first come, first served basis. Under the new rules, shareholders would have more time to decide and would not be penalized for being the last to tender.

The mantra of the legislative debates was "neutrality." According to its proponents, the Williams Act would level the playing field between bidders and target managers by preventing bidders from using the blitzkrieg tactics that they had sometimes employed. In reality, of course, leveling the playing field meant helping target managers out in the name of shareholder choice. Managers clearly benefited from the new rules, since they now had enough time to wage an effective campaign against a hostile bidder. The bidders clearly lost. Whether shareholders won or lost is a closer question, since they benefited from the elimination of coercive bids but lost to the extent the new rules had a chilling effect on cash tender offers.

The final pieces in the puzzle of U.S. takeover regulation came in the wake of the takeover boom of the 1980s.[114] Fueled by a combination of Michael Milken's discovery of the financing potential of high yield debt, deregulation, and a gentler approach by the Reagan administration to antitrust regulation, takeover activity soared to a level not seen since the great merger wave at the end of the Gilded Age. Target managers fought back with a variety of defensive strategies, the most dramatic of which was the implementation of the poison pills pioneered by Marty Lipton of Wachtell, Lipton. Since the poison pill seemed to be capable of stopping a bidder in its tracks, bidders challenged pills and other defenses as an impermissible interference with their efforts to make a tender offer to target shareholders.

Delaware courts served as the battleground for these challenges. Delaware is the state in which approximately half of America's largest corporations were incorporated. In 1985, the Delaware Supreme Court issued three landmark opinions that completed the landscape of American tender offer regulation. In *Moran v. Household International, Inc.*, the Delaware Supreme Court held that poison pills are not per se impermissible, despite the fact that they discriminate

113. *See* Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended in scattered sections of 15 U.S.C.). For an overview of the Williams Act changes, see, for example, Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*, 86 HARV. L. REV. 1250, 1254–60 (1973).

114. Milken and the development that laid the groundwork for the takeover era are surveyed in more detail in SKEEL, *supra* note 59, at 111–30.

between the tender offer bidder and other shareholders of the target company.[115] In *Unocal* and *Revlon*, the court then sketched out the initial limitations of target managers' use of poison pills and other defenses.[116] In order to defend against a takeover, managers would be required to show that the hostile offer represented a threat to the corporation and the defense was reasonably proportionate to the threat.[117] If it became clear that the company would be sold or broken up, managers' use of defenses would be limited still further: defenses would be permissible only to the extent target managers used them to try to get the highest price for their shareholders.[118]

Although the Delaware case law gave them far more discretion than they would enjoy in a shareholder choice regime, target managers persuaded the legislatures of other states to give them even more protection. By the end of the 1980s, over forty states had enacted antitakeover legislation that protected the managers of companies incorporated in the state. In many states, the legislation was enacted at the behest of a particular company. In a few others, the debate was somewhat more prolonged. But nearly everywhere, state legislatures gave target managers new tools for resisting unwanted takeover bids.[119]

B. WHAT HAPPENED IN THE UNITED KINGDOM?

As in the United States, the history of hostile takeovers in the United Kingdom began in the early 1950s. The first wave of hostile takeovers was fueled by extraordinary opportunities for asset arbitrage that were created by the economic upheavals of the postwar period.[120] The first successful bid, Charles Clore's takeover of shoe retailer J. Sears in early 1953, is a good illustration.[121] Clore realized that, owing to inflation, Sears's portfolio of city center premises

115. 500 A.2d 1346, 1348 (Del. 1985).

116. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1985).

117. *Unocal*, 493 A.2d at 954.

118. *Revlon*, 506 A.2d at 182.

119. Corporate managers' success in persuading state legislatures to pass antitakeover statutes is analyzed in Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 120–45 (1987).

120. On the one hand, government-imposed dividend restrictions led many companies to hoard cash. EDWARD STAMP & CHRISTOPHER MARLEY, ACCOUNTING PRINCIPLES AND THE CITY CODE: THE CASE FOR REFORM 5 (1970); *The Shareholder Today*, ECONOMIST, Dec. 19, 1953, at 903, 904. Meanwhile, the Companies Act of 1948 introduced new disclosure obligations, rendering such reserves more transparent than before. *See, e.g.*, Les Hannah, *Takeover Bids in Britain Before 1950: An Exercise in Business "Pre-History*,*"* 16 BUS. HIST. 65, 75–76 (1974). On the other hand, surging postwar inflation inflated the value of fixed assets, particularly land. *See, e.g.*, *Mergers Take Over*, ECONOMIST, July 4, 1959, at 41. Yet U.K. investors were used to valuing stocks on the basis of dividend yields. Historically, very little financial information had been made available about listed companies, and investors relied upon regular dividends as a credible signal of managers' commitment to investors. *See* Brian R. Cheffins, *Dividends as a Substitute for Corporate Law: The Separation of Ownership and Control in the United Kingdom*, 63 WASH. & LEE L. REV. 1273, 1275–76 (2006). As a result, whilst the value of corporate assets rose, dividend restraint caused share prices to fall.

121. Clore had, unsuccessfully, made the first hostile takeover bid two years earlier. *See, e.g.*, *Offer for F. Gorringe Capital*, TIMES (London), Apr. 28, 1951, at 9.

was substantially undervalued in its accounts.[122] Yet because investors' valuation heuristics were largely based on dividend yields, this was not reflected in its share price.[123] To exploit this, Clore made a tender offer directly to shareholders. It was considered very sharp practice and came as an enormous shock for the company's management and the City establishment in general.[124] The Sears board promised to increase dividends and to revalue the firm's property to reflect its higher current value.[125] But for the company's shareholders, this was too little, too late. A large majority accepted Clore's offer.[126]

As in the United States, much of the British business community was initially outraged by the advent of the takeover bid and believed that takeovers were harmful for industry. Managers initially felt justified in defending themselves, as is illustrated by the notorious battle for Savoy Hotel Ltd. This began later in 1953, when Harold Samuel, another financier specializing in takeovers, started buying that company's shares.[127] Samuel intended to convert the Savoy's Berkeley Hotel into commercial offices. The Savoy board responded with what would now be seen as a classic "lock-up" strategy. They arranged for the Berkeley Hotel to be sold to a new entity, Worcester (London) Co. Ltd., and leased back to Savoy on terms that required the building to be used only as a hotel.[128] The voting shares in Worcester were allotted to the trustees of Savoy's pension fund—one of whom, conveniently, was chairman of its board. There was thus no way that Samuel could convert the hotel into offices even if he succeeded in ousting the incumbent board.[129]

The Savoy board's tactics were highly controversial because their shareholders were given no say in the bid's outcome. The subsequent outcry led the United Kingdom's Board of Trade to investigate the directors' conduct.[130] The Board's report was prepared by E. Milner Holland Q.C., a leading company law barrister. Milner Holland concluded that the Savoy directors had overstepped the mark because, although they had acted in good faith, the effect of the

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122. *City Notes: The J. Sears Offer*, TIMES (London), Feb. 5, 1953, at 10.

123. *See, e.g.*, GEORGE BULL & ANTHONY VICE, BID FOR POWER 30 (3d ed. 1961).

124. Clore, a Russian émigré turned City financier, was willing to countenance tactics that City insiders considered beyond the pale. *See, e.g.*, Obituary, *Charles Clore*, TIMES (London), Nov. 19, 1979, at 26.

125. This tactic had worked for the board of a previous target of Clore's. *See Gorringe Bid Fails*, TIMES (London), June 1, 1951, at 9; *see also supra* note 121.

126. Clore then took advantage of the inflated property prices by selling and leasing back much of the company's retail property. *City Notes: J. Sears' Property Sales*, TIMES (London), Mar. 5, 1954, at 13.

127. *Savoy Shares Inquiry*, TIMES (London), Dec. 1, 1953, at 8; E. MILNER HOLLAND, Q.C., BD. OF TRADE, THE SAVOY HOTEL LIMITED AND THE BERKELEY HOTEL COMPANY LIMITED: INVESTIGATION UNDER SECTION 165(B) OF THE COMPANIES ACT, 1948: REPORT OF MR. E. MILNER HOLLAND, Q.C. 3–12 (1954) [hereinafter MILNER HOLLAND REPORT].

128. *Battle for the Savoy*, ECONOMIST, December 12, 1953, at 831, 831–32; *Savoy Group's New Company*, TIMES (London), Dec. 7, 1953, at 17.

129. *See* RONALD W. MOON, BUSINESS MERGERS AND TAKE-OVER BIDS: A STUDY OF THE POST-WAR PATTERN OF AMALGAMATIONS AND RECONSTRUCTIONS OF COMPANIES 128–32 (5th ed. 1976); L.C.B. Gower, *Corporate Control: The Battle for the Berkeley*, 68 HARV. L. REV. 1176, 1179–80 (1955).

130. *Battle for the Savoy*, ECONOMIST, December 12, 1953, at 831, 832.

scheme was to "disable [stockholders] from varying the decision of the [b]oard."[131] However, his report lacked the binding force of a court judgment;[132] indeed, the Savoy board had taken advice from another leading barrister to the effect that their scheme was perfectly lawful.[133] Direct precedents on the point were non-existent.

It was against this background of controversy that the notorious battle for British Aluminium played out. At the end of 1958, the managers of British Aluminium Ltd. ("BA") were approached by two rival camps: one from the US Reynolds Metal Company in partnership with U.K.-based Tube Investments ("TI-Reynolds"), and the other from the Aluminium Company of America ("Alcoa"). Without informing their shareholders of these developments, BA's board rejected TI-Reynolds's approach, instead agreeing to a deal with Alcoa under which the latter was issued with new shares amounting to a one-third stake in BA.[134] It was only when TI-Reynolds made clear that they intended to go over the BA directors' heads with an offer directly to the shareholders that the directors publicly revealed the Alcoa deal.[135] The BA board then tried to bribe their shareholders with a generous dividend increase, which boosted the share price considerably.[136] This, however, only served to provoke further anger that Alcoa had been permitted to buy a large block of shares at the earlier—undervalued—price.[137] Shareholders' response was quick and devastating: they dumped BA stock as fast as TI-Reynolds could buy it, thereby sealing the incumbent management's fate.[138]

The BA board's conduct provoked widespread calls for takeover regulation. In July 1959, the Governor of the Bank of England secretly invited a committee comprised of trade groups representing merchant banks, institutional investors, the largest commercial banks, and the London Stock Exchange to devise a code of conduct to regulate takeover bids.[139] This initiative seems to have been

131. MILNER HOLLAND REPORT, *supra* note 127, at 26.

132. Gower, *supra* note 129, at 1192–93.

133. MOON, *supra* note 129, at 130.

134. *See Battle for British Aluminium*, ECONOMIST, Dec. 6, 1958, at 913, 913–15. The BA board's choice was probably influenced by the fact that Alcoa intended to permit them to remain in office. *See, e.g.*, *Alcoa Proposal for Representation*, TIMES (London), Dec. 2, 1958, at 10; *Choice in British Aluminium*, ECONOMIST, Dec. 13, 1958, at 1005, 1006. Under BA's constitution, issuing new shares did not require shareholder approval.

135. *British Aluminium Board's Statement*, TIMES (London), Dec. 6, 1958, at 11; *British Aluminium Reveals Contract with Alcoa*, TIMES (London), Nov. 29, 1958, at 12.

136. *See Dividend Raised to Counter Bid*, TIMES (London), Dec. 20, 1958, at 6.

137. *See British Aluminium: A Reply Under Pressure*, ECONOMIST, Dec. 27, 1958, at 1173; *Letters to the Editor*, TIMES (London), Dec. 11, 1958, at 11; *Letters to the Editor*, TIMES (London), Jan. 9, 1959, at 11.

138. *See British Aluminium Board Changes*, TIMES (London), Feb. 18, 1959, at 10; *Control Now in Sight for Aluminium*, TIMES (London), Jan. 7, 1959, at 10; *T.I. Claim 80% Shares Held*, TIMES (London), Jan. 10, 1959, at 10; *T.I.-Reynolds Gain Control of British Aluminium*, TIMES (London), Jan. 8, 1959, at 10; *War to What Purpose?*, ECONOMIST, Jan. 10, 1959, at 145, 145–47.

139. *See Rules for Takeovers?*, ECONOMIST, Oct. 17, 1959, at 270, 270–71; *Takeover Study and Other Needed Reforms*, TIMES (London), Oct. 13, 1959, at 19.

prompted, at least in part, by the fear that if action did not appear to have been taken, the matter would be taken out of the City's hands by legislation.[140] Indeed, shortly afterwards, Prime Minister Harold Macmillan announced a review of the working of company law, including takeovers.[141]

In the autumn of 1959, the Bank's committee announced the *Notes on Amalgamation of British Businesses*. The *Notes* contained a series of general guidelines that were "concerned primarily to safeguard the interests of shareholders."[142] The first of the *Notes*' four main principles stated that there should be no interference with the free market in shares, and the second that it was to be for the shareholder himself to decide whether to sell. The *Notes* also called for shareholders to be given enough information to make an intelligent decision, and enough time to digest it.[143] The principle of shareholder primacy—and correlative board neutrality—was thus established. In keeping with the gentlemanly spirit in which the City did business at the time, the principles established by the *Notes* were dubbed the "Queensberry Rules," after the rules drafted by the Marquess of Queensberry to regulate prize-fighting.[144] The Bank of England's circulation of the *Notes* seemed to have the effect of heading off demands for legislative intervention.[145]

Although the *Notes* were generally well-received, and were revised and improved in 1963,[146] their influence on the U.K. takeover market was limited by the lack of mechanisms for adjudication and enforcement. Things came to a head in 1967, when in a battle between two bidders for control of Metal Industries Ltd. ("MI"), a third party bought a block of shares in the market and

140. *See* 606 PARL. DEB., H.C. (5th ser.) (1959) 21–22 (calling for Parliamentary Committee to investigate takeover bids and create code of ethics); *A Problem of Communication: The City Starts to Explain Itself*, TIMES (London), Oct. 19, 1959, at iii ("In the light of recent events it is clear that some official (or semi-official through the relevant trade association) regulation is needed if the public is to have the protection it ought to have.").

141. The Board of Trade announced the setting up of the Jenkins Committee on company law in November. *See Company Law*, TIMES (London), Nov. 28, 1959, at 7.

142. Editorial, *Take-Over Ethics*, TIMES (London), Oct. 31, 1959, at 7.

143. *See, e.g.*, *City Code of Conduct on Take-Over Bids*, TIMES (London), Oct. 31, 1959, at 6; *Queensberry Rules for Bids*, ECONOMIST, Oct. 31, 1959, at 440, 441.

144. As the *Economist* put it:

> These are rules of conduct which have been followed by sensible and responsible people in industry and in the City for most of the time. They do not deny businessmen the right to fight out an issue, but they do establish Queensberry rules against low hitting and butting with the head.

Queensberry Rules for Bids, ECONOMIST, Oct. 31, 1959, at 440, 442.

145. The only "hard law" reform that impinged upon takeovers was the Board of Trade's introduction in 1960 of new rules for licensed securities dealers, which required bids to be open for a minimum of 21 days, and the disclosure of certain information about bidders. *See New Rules for Take-Overs*, TIMES (London), May 10, 1960, at 20. Although the Jenkins Committee did make more extensive proposals in relation to takeovers, they were never implemented. *See* BOARD OF TRADE, REPORT OF THE COMPANY LAW COMMITTEE 98–110 (1962).

146. *Take-Over Bids: Principles and Procedure*, ECONOMIST, Nov. 2, 1963, at 511, 511. The *Revised Notes* were published on October 31, 1963. *See, e.g.*, *Revised Code on Take-Over Practices*, TIMES (London), Oct. 31, 1963, at 19.

sold these to one of the bidders—enough to secure control.[147] Enough, that was, until MI's board responded by issuing fresh shares to the other bidder—the very tactic that had provoked outrage in the case of British Aluminium.[148] By the summer of 1967, *The Economist* concluded that the widespread evasion of the *Notes*' principles made them "a dead letter."[149]

The financial press suggested that the only hope for a well-functioning takeover market would be a governmental agency with oversight authority, along the lines of the SEC.[150] But a British SEC was not to be. In July 1967, Prime Minister Harold Wilson insisted that statutory rules were not the answer.[151] Within days, the Bank of England's Working Party had reconvened to begin drafting a new set of takeover rules.[152] By the end of March 1968—the year when U.S. lawmakers enacted the Williams Act's federal tender offer rules—the draft *Takeover Code* was ready. The new *Code* was very much in the same shareholder-oriented spirit as the earlier *Notes*, but its form was more specific.[153] It consisted of a series of ten general principles, instantiated in thirty-five specific rules. Not surprisingly, many of its details could be traced to the problems that had surfaced in the takeover transactions of the previous years. The basic principle of shareholder choice, taken from the *Notes*, was now supplemented by a general ban on frustrating actions and specific prohibitions of transactions likely to induce this—issuing shares, disposing of material assets or entering into a significant contract—without the approval of the shareholders. Similarly specific requirements were set out in relation to the equal treatment of shareholders.

For the first time, too, a body of individuals was entrusted with the task of "adjudicating" disputes about the application of the rules. The City Panel on Takeovers and Mergers was inaugurated on March 27, 1968.[154] Its nine members, who were drawn from the organizations represented on the Working Party,

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147. *See, e.g.*, *Coup Behind the New Bid for MI*, TIMES (London), June 8, 1967, at 26; *Victory in MI Fight Cost Aberdare £14m*, TIMES (London), July 13, 1967, at 19.

148. *See All for the Lack of a Referee*, TIMES (London), July 17, 1967, at 21; *Back to the Jungle*, ECONOMIST, July 22, 1967, at 337, 337; Sandy McLachlan & Philip Jacobson, *Thorn Deal with MI Strips Control Away from Aberdare*, TIMES (London), July 17, 1967, at 17. Contemporaneously, the board of International Distillers and Vintners used a similar tactic, staving off a hostile bid by persuading a friendly third party to buy a substantial stake in the market. *See* Roy Mackie, *Watney Mann Was Mystery Buyer of IDV Shares*, TIMES (London), July 25, 1967, at 17.

149. *Back to the Jungle*, *supra* note 148, at 337; *see also The Takeover Code That Died*, TIMES (London), Dec. 29, 1967, at 19.

150. *See, e.g.*, *The Case for a British SEC*, ECONOMIST, Jan. 7, 1967, at 49, 49; *Time for a Tough Line in the City*, TIMES (London), July 18, 1967, at 23.

151. *See Back to the Jungle*, *supra* note 148, at 338.

152. *See* Roy Mackie, *City Acts To Put Its House in Order*, TIMES (London), July 20, 1967, at 17; Roy Mackie, *City Panel to Oversee Takeovers*, TIMES (London), Sept. 21, 1967, at 19; *Takeover Code: Enforceable*, ECONOMIST, Sept. 23, 1967, at 1130, 1130.

153. *See A Momentous Stride Forward for the City*, TIMES (London), Mar. 27, 1968, at 27.

154. THE PANEL ON TAKE-OVERS AND MERGERS, REPORT ON THE YEAR ENDED 31ST MARCH 1969, at 3 (1969), http://www.thetakeoverpanel.org.uk/new/reports/DATA/Report1969.pdf [hereinafter TAKEOVER PANEL, 1969 REPORT].

consciously decided that proactive involvement was better than an ex post judicial approach.[155] This soon became institutionalized as the Panel's characteristic "real time" guidance in takeover cases.[156] However, the wholly non-executive Panel seems to have been overwhelmed by the volume of business—575 cases in its first year[157]—and its responses to several high-profile infringements of the Code were disappointing.[158] *The Economist* complained that aggressive bidders were running a "coach and horses through the Code" and insisted that the time had come for a "professional referee" with a full range of legal sanctions at its disposal.[159] Although Prime Minister Harold Wilson announced he had "no desire to introduce legislation to force on the City the much tougher and more wide-ranging interference which free enterprise America has devised in the form of the Securities and Exchange Commission,"[160] the government made clear that they would be forced to legislate unless the Panel quickly reformed its oversight techniques.[161]

Over the next few months, three major changes were announced that would transform the Panel. First, the Panel was given a full-time executive staff, paid for by City institutions. Lord Shawcross, a political heavyweight who had formerly been both Attorney-General and President of the Board of Trade,[162] was persuaded to serve as non-executive Chairman, and Ian Fraser, an experienced takeover specialist from S.G. Warburg, was recruited as executive Director-General.[163] Secondly, due process protection was added to the Panel's procedures. An Appeal Committee was constituted, the first President of which was a former

155. *See id.* at 4.

156. *See, e.g.*, *Familiar Technique of a "Quiet Word in the Ear,"* TIMES (London), June 15, 1968, at 13.

157. TAKEOVER PANEL, 1969 REPORT, *supra* note 154, at 8.

158. These were (i) the Courtalds-Dufay battle for International Paints, which involved a breach of the Code's information requirements, *see, e.g.*, *Courtaulds Criticized*, TIMES (London), June 25, 1968, at 21; (ii) the American Tobacco-Philip Morris battle for Gallaher, a British tobacco company, *see, e.g.*, *Cazenove Unshaken by Panel's Attack*, TIMES (London), July 20, 1968, at 11; Philip Jacobson, *City Row Flares as Panel Censures Gallaher Bid Deals*, TIMES (London), July 19, 1968, at 17; *Takeover Panel's Attack of Cold Feet*, TIMES (London), July 26, 1968, at 24; and (iii) the battle for the *News of the World* newspaper, which first pitted Robert Maxwell against Rupert Murdoch; *see, e.g.*, *News of the World: Maxwell Loses Vote, Panel Loses Face*, ECONOMIST, Jan. 4, 1969, at 58, 58; *Wanted: New Takeover Body*, TIMES (London), Oct. 26, 1968, at 17; *see also* 4 DAVID KYNASTON, THE CITY OF LONDON, 375–85 (2001).

159. *Coach and Horses Through the Code*, ECONOMIST, July 20, 1968, at 76, 76.

160. JOHNSTON, *supra* note 66, at 49.

161. *See, e.g.*, *BoT Gives Warning of Takeover Discipline*, TIMES (London), Nov. 1, 1968, at 21; Christopher Marley, *Takeover Code Will Remain Voluntary*, TIMES (London), Dec. 12, 1968, at 21; *Takeover Panel Gets One More Chance*, TIMES (London), Nov. 6, 1968, at 16.

162. *See, e.g.*, *Two New Cabinet Ministers: Sir Hartley Shawcross and Mr Alfred Robens*, TIMES (London), Apr. 25, 1951, at 6.

163. *See, e.g.*, *Enter the New Police Chiefs*, ECONOMIST, Mar. 1, 1969, at 75, 75; *Shawcross Asked to Head Takeover Panel*, TIMES (London), Feb. 21, 1969, at 17. As part of his preparation for the role, Fraser spent a week at the SEC in Washington to learn about the U.S. approach to takeover regulation. *See* Philip Jacobson, *Panel Chief Studies US Methods*, TIMES (London), Apr. 27, 1969, at 17.

Law Lord.[164] Finally, and most importantly, the sanctions available to the Panel were dramatically enhanced. These piggybacked on the existing authority of the Stock Exchange and the Board of Trade.[165] The Stock Exchange had the power to censure, suspend or expel a company from the Official List, and the Board of Trade had similar authority over licensed share dealers. Moreover, the various trade associations represented in the Working Party agreed to impose sanctions upon their members—up to and including stripping them of membership—if asked to do so by the Panel.[166] This gave the Panel a range of responses, ranging from public censure through trade association sanctions to complete withdrawal of the right to deal in securities and/or de-listing. The introduction to a subsequent version of the Code made this clear:

> The Code has not, and does not seek to have, the force of law, but those who wish to take advantage of the facilities of the securities markets in the United Kingdom should conduct themselves in matters relating to take-overs according to the Code. Those who do not so conduct themselves cannot expect to enjoy those facilities and may find that they are withheld.[167]

The status of the Panel as regulators of U.K. takeovers was cemented by its very firm, but even-handed, response to problems in a 1969 takeover of Pergamon Press by American Leasco Data Processing Equipment Corp.[168] A series of revelations about murky accounting practices and insider dealing at Pergamon, 31% of which was held by Robert Maxwell, gave Leasco cold feet about the deal.[169] The Panel insisted on full disclosure, and asked the Board of Trade to conduct an investigation into Pergamon's affairs.[170] The Panel's decisive intervention greatly enhanced its credibility and quieted calls for a British

164. *See Lord X and the City*, TIMES (London), May 20, 1969, at 29 (naming Lord Pearce as the President of the Appeal Committee).

165. *See Teeth at Last—But How Will They Bite?*, TIMES (London), Feb. 26, 1969, at 29; *The Panel: Big and Little Sanctions*, ECONOMIST, May 3, 1969, at 74, 74; *Vital Assignment for Mr Fraser*, TIMES (London), Apr. 29, 1969, at 27.

166. *See, e.g.*, *Support Grows for the City's New Code*, TIMES (London), June 30, 1969, at 19. The trade associations pledging to bind their members to observe the Code were the Council of the Stock Exchange (stockbrokers and jobbers), the Issuing Houses Association (merchant banks), the British Insurance Association, the Association of Unit Trust Managers and the Association of Investment Trust Companies. *See id.*; THE PANEL ON TAKEOVERS AND MERGERS, THE CITY CODE ON TAKEOVERS AND MERGERS (1969) (U.K.).

167. THE PANEL ON TAKEOVERS AND MERGERS, THE CITY CODE ON TAKEOVERS AND MERGERS 5–6 (1981).

168. *See* Michael Blanden, *The City Regulations on Mergers and Takeovers*, *in* READINGS ON MERGERS AND TAKEOVERS, 199, 205–06 (J.M. Samuels ed., 1972).

169. *See, e.g.*, Robert Jones, *600,000 Pergamon Shares Sold*, TIMES (London), Aug. 21, 1969, at 15; *Americans Drop Bid for Maxwell Company*, TIMES (London), Aug. 22, 1969, at 1; Robert Jones & Christopher Marley, *Stock Exchange Is Asked to Suspend Pergamon Dealings*, TIMES (London), Aug. 22, 1969, at 15.

170. *See, e.g.*, Robert Jones, *Pergamon: Takeover Panel Calls for Board of Trade Inquiry*, TIMES (London), Aug. 28, 1969, at 15; Robert Jones, *New Shock for City: Takeover Panel To Widen Its Inquiries*, TIMES (London), Aug. 29, 1969, at 17; *A True and Fair View*, ECONOMIST, Aug. 30, 1969, at 43, 44.

SEC.[171]

Although the Panel's immediate future was safe, its Chairman, Lord Shawcross, was well aware of how little it would take, especially with the left-leaning Labour governments of the 1970s, to provoke legislative intervention.[172] In his view, the Panel needed to do more than simply to reflect contemporary best practice. If another scandal occurred, critics would simply conclude that "best" practice was not good enough. Rather, it had to ensure that there were no further scandals. To do this, the Panel became involved in the continuous development of *better* practice. It updated its rules proactively in response to developments in the market,[173] in so doing focusing heuristically on the needs of the "small shareholder."[174] As he reiterated in the Chairman's statements to successive Annual Reports of the Panel, Shawcross firmly believed that the Panel was able to perform this norm development function more quickly and effectively than a regulator established by a legislative system, such as the SEC.[175]

One of the most important such innovations was the so-called "mandatory bid" rule. Following the announcement of two rival bids for Venesta International in 1971, David Rowland, a shareholder in the company, started to buy its shares heavily in the market. Whilst stating simply that he wished to preserve

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171. *See, e.g.*, Christopher Marley, *Takeover Panel Sets Standards*, TIMES (London), May 9, 1972, at v ("The panel . . . have been outstandingly successful by the standards of 1969."); *More Questions for the Takeover Panel*, TIMES (London), Nov. 21, 1969, at 27; *Takeover Panel: Getting to Know You*, ECONOMIST, May 9, 1970, at 83, 83 (describing the resolution of the Pergamon investigation as "quite an achievement for an instrument created by the City's institutions themselves, by common consent owing much to the prestige which Lord Shawcross has brought to the chairmanship and the appointment of a permanent director-general").

172. *See, e.g.*, THE PANEL ON TAKE-OVERS AND MERGERS, REPORT ON THE YEAR ENDED 31ST MARCH, 1975 AND 1976, at 3–4 (1976) (U.K.), http://www.thetakeoverpanel.org.uk/new/reports/DATA/Report1975&76.pdf [hereinafter TAKEOVER PANEL, 1975–1976 REPORT]; Anthony Rowley, *Stock Exchange Attacks "Alarming Prejudice" of Labour Green Paper*, TIMES (London), July 18, 1974, at 21; Christopher Wilkins, *Who Should Regulate the City?*, TIMES (London), May 30, 1974, at 23.

173. *See, e.g.*, THE PANEL ON TAKE-OVERS AND MERGERS, REPORT ON THE YEAR ENDED 31ST MARCH 1973, at 3, 9–10 (1973), http://www.thetakeoverpanel.org.uk/new/reports/DATA/Report1973.pdf [hereinafter TAKEOVER PANEL, 1973 REPORT] (urging legislation on insider dealing); Hugh Stephenson, *The City Code and Shareholder Rights*, TIMES (London), Apr. 8, 1974, at 18 (proposing a new rule restricting a bidder's ability to withdraw its bid).

174. *See, e.g.*, THE PANEL ON TAKE-OVERS AND MERGERS, REPORT ON THE YEAR ENDED 31ST MARCH, 1978, at 5 (1978), http://www.thetakeoverpanel.org.uk/new/reports/DATA/Report1978.pdf [hereinafter TAKEOVER PANEL, 1978 REPORT] ("[T]he interests of *all* shareholders have to be considered. . . . [I]t is right that the institutions should increasingly interest themselves in the management of companies in which they invest and in so doing should regard themselves as in a sense representing the interest of all shareholders.") (emphasis in original); *see also* THE PANEL ON TAKE-OVERS AND MERGERS, REPORT ON THE YEAR ENDED 31ST MARCH, 1980, at 6 (1980), http://www.thetakeoverpanel.org.uk/new/reports/DATA/Report1980.pdf [hereinafter TAKEOVER PANEL, 1980 REPORT] ("I am influenced by my keen belief that small shareholders should be given every assistance and protection.").

175. *See, e.g.*, TAKEOVER PANEL, 1973 REPORT, *supra* note 173, at 3; THE PANEL ON TAKEOVERS AND MERGERS, REPORT FOR THE YEAR ENDED 31ST MARCH, 1974, at 3–4 (1974), http://www.thetakeoverpanel.org.uk/new/reports/DATA/Report1974.pdf; TAKEOVER PANEL, 1975–1976 REPORT, *supra* note 172, at 3–4.

the value of his investment by avoiding the takeover, he obtained a controlling interest in the company without making a bid. The Panel was concerned that Rowland's open market purchases denied the company's small shareholders the opportunity to sell at the favorable terms Rowland had offered.[176] Their response was a new rule requiring any person who purchased 40% or more of a company's shares to make a bid for the remainder.[177] The threshold was lowered to 30% in 1974, where it has since remained.[178]

The emergence of the Panel as the principal source of regulatory oversight over U.K. takeovers can hardly be described as an illustration of spontaneous order in action. Rather, it is better characterized as coerced self-regulation, made under a clear governmental threat of intervention.[179] But the regulatory strategy that emerged during the same era as Delaware enacted its 1967 reforms and the SEC helped to shape the 1968 Williams Act looks remarkably different from the U.S. approach. Unlike in the United States, where the contours of takeover regulation are hammered out in the courts, the Panel approach managed to keep lawyers out of the process. And despite the steady drumbeat of calls for a "professional regulator," U.K. lawmakers continued to look to coerced self-regulation rather than an American-style SEC as the principal source of oversight in the takeover context. In the words of a leading English judge, Sir John Donaldson M.R.:

> The Panel on Take-overs and Mergers is a truly remarkable body. Perched on the 20th floor of the Stock Exchange building in the City of London, both literally and metaphorically it oversees and regulates a very important part of the United Kingdom financial market. Yet it performs this function without visible means of legal support.[180]

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176. *See, e.g.*, *New Problem for the Panel*, TIMES (London), Dec. 18, 1971, at 19.

177. *New Takeover Code Rule: Buyer Gaining 40pc Stake Must Bid for Remainder*, TIMES (London), Jan. 19, 1972, at 17; *see* THE PANEL ON TAKEOVERS AND MERGERS, REPORT FOR THE YEAR ENDED 31 MARCH 1972, at 7 (1972), http://www.thetakeoverpanel.org.uk/new/reports/DATA/Report1972.pdf [hereinafter TAKEOVER PANEL, 1972 REPORT] (explaining that the addition of Rule 35 "brings within the scope of the Code any series of purchases (or other acquisitions) of shares, however gradual, which brings about a change of effective control"); *see also* TAKEOVER PANEL, 1973 REPORT, *supra* note 173, at 6 (confirming that Rule 35 established the 40% threshold rule). The new rule closely complemented another change requiring a bidder who had acquired more than 15% of the target's shares in the market during the previous year to make a *cash* offer at the highest price paid during that time. *See* TAKEOVER PANEL, 1972 REPORT, *supra*, at 6 (explaining that the addition of Rule 33 "makes it obligatory for an offeror who has a paper offer outstanding to provide a cash alternative in cases where his offer is accompanied or preceded by massive cash purchases"); TAKEOVER PANEL, 1973 REPORT, *supra* note 173 (confirming that Rule 33 established the 15% threshold rule).

178. *Revised City Code Sets Out New Rules on Mandatory Bids*, TIMES (London), June 6, 1974, at 19.

179. *See* IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE 101–32 (1992) (discussing the enforced self-regulation concept).

180. R v. Panel on Take-overs and Mergers, [1987] Q.B. 815, 824.

III. EXPLAINING THE DIVERGENCE: FROM PROCESS TO SUBSTANCE

Having chronicled the remarkable divergence of U.S. and U.K. takeover regulation, we turn now to the question of *why* these two countries have taken such different paths when it comes to regulating takeovers. We begin with the most obvious explanation, which is derived from the marvels of American federalism. As we shall see, however, this "orthodox" story raises nearly as many questions as it answers. We develop a richer analysis that draws on the historical developments described in the previous part, focusing in particular on the influence of institutional shareholders in the United Kingdom and on the foreclosure of self regulation in the United States. Both paths, it turns out, were the largely unintended consequences of legislation that had other objectives.

A. THE ORTHODOX STORY: FEDERALISM AND PRO-MANAGER TAKEOVER LAW

For even longer than they have been debating directors' proper response to takeovers, American corporate scholars have debated whether Delaware's supremacy as the state of choice for America's largest corporations is the product of a "race to the bottom" or a "race to the top."[181] The race to the bottom view posits that state lawmakers cater to managers, and thus have powerful incentives to favor managers at the expense of shareholders, whereas race to the top advocates believe that market pressures force Delaware and other states to regulate with shareholders in mind. The federalism that makes this state lawmaking possible provides the most obvious explanation for the U.S. approach to takeover regulation.

In the past decade, a subtler version of the original race to the bottom theory has emerged, and has become increasingly influential in corporate law circles. This view proposes that charter "competition" is hardly a competition at all. Delaware, which roughly sixty percent of the largest corporations now call home, has a monopoly share of the market.[182] Delaware's monopoly is made possible, in part, by the fact that there is no open, nationwide competition between Delaware and forty-nine other states. Rather, Delaware competes with just one other state at a time—the "home" state of a corporation that is considering relocating to Delaware.[183] The upshot is that Delaware has at least some ability to favor managers' interests, and it can charge supracompetitive prices for the privilege of incorporating in the nation's second smallest state.

181. The wellspring of the debate in its current incarnation was a scathing indictment of Delaware by former SEC chair William Cary. *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974). Delaware's leading defender is Roberta Romano. *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993). With the advent of the European Union, the debate has become a staple in the European literature as well. *See generally* sources cited *supra* note 7.

182. *See, e.g.,* Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002).

183. *See, e.g.*, Lucian Bebchuk, Alma Cohen, & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law*, 90 CAL. L. REV. 1775, 1815 (2002).

It is a short step from this new orthodoxy to a straightforward political explanation for the divergence of U.S. and U.K. takeover regulation. In the United States, federalism has amplified the voice of corporate managers. Because they worry that managers will pack the company's bags and move elsewhere if the state is insufficiently attentive to the managers' needs, state lawmakers have powerful incentives to keep corporate managers happy.[184] This suggests that managers will often get what they want both in Delaware and in other states. In the United Kingdom, by contrast, which does not have this federalist structure, corporate managers exert far less influence.[185]

The orthodox account rings true in some respects. Managers clearly do influence the shape of state corporate law—particularly with respect to takeovers. But the federalism story also has at least two puzzling limitations. First, whilst it offers a superficially plausible explanation for the general substantive content of U.S. takeover regulation, it implies that Delaware law is likely to be more manager-friendly—and less efficient—than the laws of other states. After all, if Delaware judges and lawmakers have a greater stake in pacifying corporate managers than any other state, their handiwork should pander correspondingly more to managers' interests. Yet this conclusion fits poorly with the existing evidence.[186] Delaware was one of the last states to enact an antitakeover statute, for instance, and its statute gives managers far less discretion than those rushed into the code books by other state legislatures.[187] There is also strong empirical evidence that reincorporating in Delaware increases a company's value, rather than undermining it.[188] Delaware's critics have labored mightily to explain these observations,[189] but the evidence suggests that a

184. Reincorporation does require a shareholder vote, but race to the bottom theorists argue that the vote is an ineffective check, either because of shareholders' collective action problems or because the reincorporation vote is muddied by other, more positive reasons for moving to the new state.

185. Geoff Miller, one of the few commentators who has considered the U.S.-U.K. contrast in takeover regulation, reaches a similar conclusion in a brief discussion of the political dynamics. "The federal principles which generate strong pressures for antitakeover legislation at the state level in the U.S.," he notes, "are not present in England. . . . In such an environment, antitakeover legislation is not likely to be observed." Geoffrey Miller, *Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England*, 1998 COLUM. BUS. L. REV. 51, 75 (1998). Miller's analysis differs somewhat from ours in that he focuses on the political influence of potential bidders and targets, but does not consider the role of the shareholder and merchant banking interests who historically were influential in shaping the U.K. regulatory environment.

186. *See, e.g.*, Jonathan R. Macey, *Displacing Delaware: Can the Feds Do a Better Job Than the States in Regulating Takeovers?*, 57 BUS. LAW 1025, 1034–36 (2002).

187. *See, e.g.*, Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 855–56 (1993).

188. Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001). *But see* Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32 (2004) (suggesting that Delaware's positive effect on share prices was temporary and Delaware now has no statistical effect).

189. *See, e.g.*, Bebchuk et al., *supra* note 183, at 1820–21 (questioning the significance of empirical findings purporting to suggest that reincorporation in Delaware increases a company's value, based, among other things, on the possibility that Delaware may provide desirable law on some issues but undesirable ones on others).

theory predicated on an assumption that Delaware corporate regulation is less efficient than other states may not be the whole story.

The second limitation deepens the mystery. As our historical analysis has shown, the single most striking difference between U.S. and U.K. takeover regulation is not the substance but the *mode* of regulation: the United States looks to formal law, whereas norms-based self regulation holds sway in the United Kingdom. Yet the orthodox federalism story does not seem to give us tools for understanding why U.S. and U.K. takeover regulation differ not just in substantive terms, but also in the principal mode of regulation.[190] A more compelling political account must also explain the divergent *modes* of regulation.

To identify the starting points for a richer political account, we need only return to our historical overview and ask, which of the players and events that figured prominently in the historical development of U.S. and U.K. takeover regulation seem to be missing from the orthodox federalism story? The answers, in our view—the dogs that didn't bark in the last section—are institutional shareholders in the United Kingdom, and the early twentieth-century securities and banking legislation that determined the path of U.S. corporate regulation. Together, they hold the key to understanding the divergent modes of regulation in the United States and United Kingdom. This time we begin our account across the water in the United Kingdom.

B. SELF-REGULATION BY INSTITUTIONAL INVESTORS: THE CASE OF THE UNITED KINGDOM

Institutional shareholders played a far greater role in the development of U.K. takeover regulation than in the United States. Every time large financial institutions were poised to play an outsized role in American corporate governance in the twentieth century, politicians intervened, forcing corporate ownership to remain fragmented and discouraging big financial institutions from substantially raising their profile.[191] Although mutual funds, pension funds and other institutional shareholders now hold a large percentage of U.S. equities, their holdings were relatively insignificant during the crucial periods in the development of takeover regulation (see Figure 1). It was only in the 1990s—by which time the contours of Delaware's takeover doctrine had largely been established—that U.S. institutional investors became a significant force in corporate gover-

190. Thus, as noted earlier, Lucian Bebchuk has pointed to the U.K. approach in support of an argument for new mandatory shareholder choice regulation in influential recent work without addressing the fact that U.K. takeover regulation relies on self-regulation rather than formal, mandatory law. *See* Bebchuk & Ferrell, *supra* note 3, at 847–50.

191. This point, discussed in more detail below in the text accompanying notes 237–241, is generally associated with Mark Roe's classic work on the politics of American corporate governance. *See generally* ROE, *supra* note 6.

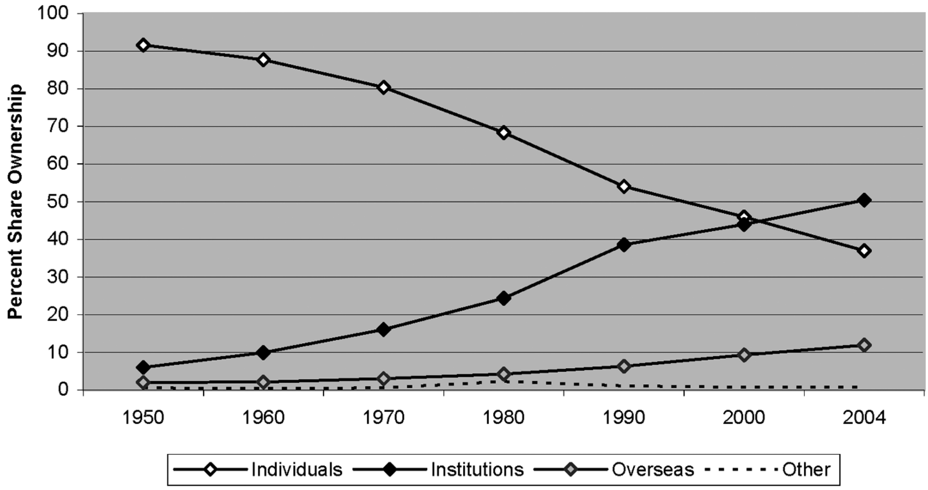

Figure 1: Share ownership patterns in the United States, 1950–2004[193]

nance.[192] The impetus behind the legislation that restricted institutions was a populist desire to rein in the monopoly power of the "Money Trust." This had the largely unintended consequence of granting managers considerable autonomy from shareholder control.

In contrast, institutional investors became important much earlier in the United Kingdom. The proportion of U.K. stocks owned by pension funds, insurance companies and unit trusts (the British equivalent of mutual funds) rose dramatically during the 1960s and 70s, as Figure 2 illustrates. Unlike their American counterparts, British institutions were not held back from investing in stocks. Indeed, quite the reverse. The emergence of strong institutional investors in Britain was, in part, an unintended consequence of various legislative measures that had the effect of actively promoting their ownership of stock.[194] Three were particularly important.

The first, and probably most important, factor, was the punitively high rates of marginal taxation applied to investment income for individuals from the end of World War II until 1979: the top marginal rate was 90% for most of this

192. *See, e.g.*, Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 827–28 (1992); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 447 (1991).

193. BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS IN THE UNITED STATES: ANNUAL FLOWS AND OUTSTANDINGS, 1995–2005, at 82 tbl.L.213 (2006); Benjamin M. Friedman, *Economic Implications of Changing Share Ownership*, J. PORTFOLIO MGMT., Spring 1996, at 59, 60 (1996).

194. *See* Steven A. Bank & Brian R. Cheffins, Tax and Ownership Structure 50–51 (2006) (unpublished manuscript, on file with authors).

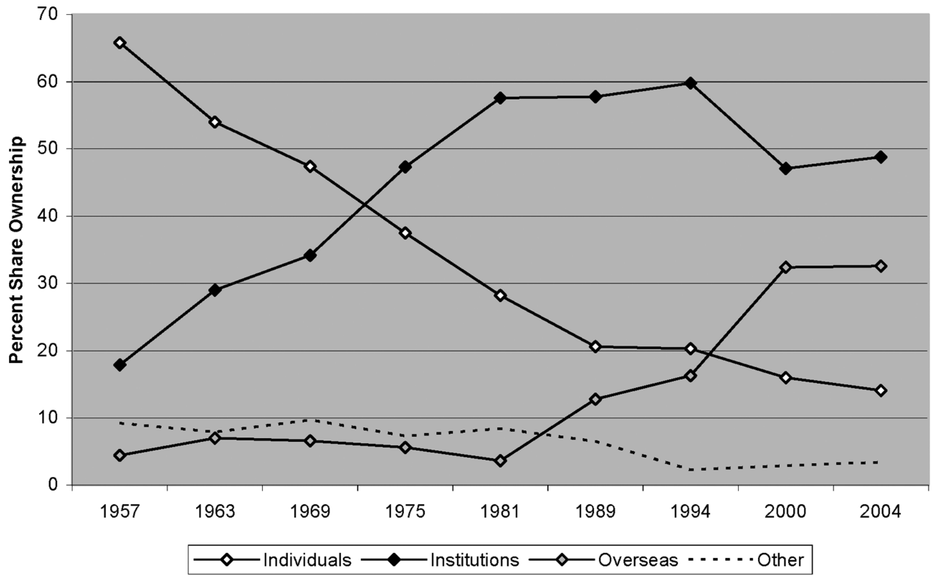

Figure 2: Share ownership patterns in the United Kingdom, 1957–2004[195]

period, rising to 98% from 1974–1979.[196] Secondly, tax relief was at the same time accorded to collective investment schemes. The most extensive was that granted to pension funds, which were entirely exempt from tax on dividend income, part and parcel of the United Kingdom's favorable tax environment for private pension plans.[197] However, insurance companies also enjoyed a favorably low rate of tax on dividend income.[198] Together, these factors exerted a pressure away from individual and towards collective ownership of shares.[199]

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195. OFFICE FOR NAT'L STATISTICS, SHARE OWNERSHIP: A REPORT ON OWNERSHIP OF SHARES AS AT 31ST DECEMBER 2004, at 9 (2005); John Moyle, *The Pattern of Ordinary Share Ownership: 1957–1970*, at 6–7 (Univ. of Cambridge Dep't of Applied Econ., Occasional Paper No. 31, 1971).

196. *See, e.g.*, Tom Clark & Andrew Dilnot, *Long-Term Trends in British Taxation and Spending* 7–8 (Inst. for Fiscal Studies, Briefing Note No. 25, 2002), *available at* http://www.ifs.org.uk/bns/bn25.pdf. Under the Thatcher government, the top marginal rate was lowered to 60% in 1979 and then to 40% in 1988. *Id.*

197. *See* Leslie Hannah, *Why Employer-Based Pension Plans? The Case of Britain*, 45 J. ECON. HIST. 347, 354 n.20 (1985); *see generally* HM TREASURY, INSTITUTIONAL INVESTMENT IN THE UNITED KINGDOM: A REVIEW 29 (2001), *available at* http://www.hm-treasury.gov.uk/media/2F9/02/31.pdf [hereinafter MYNERS REVIEW]. The tax exemption accorded to U.K. pension funds' investment income was abolished in July 1997. *See* Leonie Bell & Tim Jenkinson, *New Evidence on the Impact of Dividend Taxation and the Identity of the Marginal Investor*, 57 J. FIN. 1321, 1321–22 (2002).

198. *Shareholders: Why So Few?*, ECONOMIST, July 2, 1966, at 52, 52.

199. It is sometimes suggested that high rates of postwar inflation contributed to institutional investors' preference for equities, as opposed to fixed-income securities. *See, e.g.*, MYNERS REVIEW, *supra* note 197, at 32). While this undoubtedly led institutions to favor shares over fixed-income investments, it would have had a similar impact on all investors and so does not fully explain why institutions' stock holdings increased *relative to individuals*.

As executors of the estates of those who held large stock portfolios sold shares, for instance, hefty income taxation on dividends for individuals coupled with tax breaks for collective investments meant that the buyers of these shares tended to be institutions.[200]

As Figure 2 shows, institutional investors first started to accumulate significant proportions of shares in British companies in the mid-1950s. By the mid-1960s, they were firmly established at the heart of U.K. corporate governance.[201] Their ownership continued to rise until the early 1990s. For the whole of this period, the institutions have been a catalyst for developments in U.K. corporate governance.

As collective investors, it might be thought that institutions are able to overcome the free-rider problem that bests individual shareholders in disciplining corporate management. Yet British institutional investors have long been notoriously passive regarding the performance of individual companies, preferring, in the terminology popularized by Albert Hirschman, "exit" to "voice"[202] (that is, selling their shares rather than getting involved in putting pressure on management).[203] Policymakers periodically debate possible techniques to encourage—or compel—institutions to take a greater interest in the firms in which they invest.[204] Yet a relatively large block of shares must be held for free-rider problems to be overcome with respect to individual companies. Most institutions hold diversified portfolios, so their stakes in individual companies tend to be proportionately small[205] and coordination between them is costly. While some intervention does occur "behind the scenes," it tends to occur only *in extremis*.[206] In most cases, though, the game is just not worth the candle.

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200. Jack Revell, *Who Is Selling Shares?*, TIMES (London), Nov. 24, 1966, at 18 (report of survey of shares sold during 1963: many shares sold on death of individuals; most purchased by institutions).

201. *See, e.g.*, *Equity Investment and Its Responsibilities*, ECONOMIST, July 4, 1964, at 75, 75 ("Collectively these bodies have a power to influence boards of directors that a large number of small shareholders can never have.").

202. *See generally* ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

203. For a discussion on reasons why shareholders avoid pressuring management, see, for example, JOHNATHAN CHARKHAM & ANNE SIMPSON, FAIR SHARES 137–39, 171–73 (1999); Black & Coffee, *supra* note 6, at 2055–72; Paul L. Davies, *Institutional Investors in the United Kingdom*, *in* CONTEMPORARY ISSUES IN CORPORATE GOVERNANCE 69, 89–90 (D.D. Prentice and P.R.J. Holland eds., 1993).

204. *See, e.g.*, SIR ADRIAN CADBURY, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE ¶¶ 6.9–6.16 (1992), *available at* http://rru.worldbank.org/Documents/PapersLinks/1253.pdf [hereinafter THE CADBURY REPORT]; MYNERS REVIEW, *supra* note 197, at 89–94.

205. *See* Marc Goergen & Luc Renneboog, *Strong Managers and Passive Institutional Investors in the UK*, *in* THE CONTROL OF CORPORATE EUROPE 259, 268–70 & figs.10.3–10.4 (Fabrizio Barca & Marco Brecht eds., 2001) (median block held by largest shareholder in U.K. listed companies approximately 10% of voting rights).

206. *See* STAPLEDON, *supra* note 23, at 122–29 (noting that institutional coalitions are formed to pressure the board—through threat of a subsequent shareholder meeting and removal—to replace the CEO); Rafel Crespí-Cladera & Luc Renneboog, *Corporate Monitoring by Shareholder Coalitions in the U.K.* (Eur. Corp. Governance Inst., Finance Working Paper No. 12/2003, 2003), *available at* http://ssrn.com/abstract=379124 (finding that turnover of executives occurs only *in extremis*). Insurance companies appear to spearhead institutional investor engagement in such circumstances. *See id.*, at

The way in which institutional investors have made a difference to U.K. corporate governance has, in contrast, been through their influence on rulemaking—that is, the formation of formal and informal norms that govern the operation of corporate enterprise.[207] In a range of different contexts—including the strengthening of preemption rights,[208] the disuse of non-voting shares and other embedded takeover defenses,[209] the strengthening of Listing Rules requiring shareholder consent for major corporate transactions,[210] and the introduction of the Combined Code on Corporate Governance (dealing with issues of board structure, tenure and compensation)[211]—U.K. institutional investors have been active either in lobbying regulators or in seeding market norms.

To be sure, free-rider effects are present in lobbying and rulemaking activity too. But two factors make this a more effective means of intervention than attempts to improve individual companies' governance. First, while exit is a rational strategy with particular investments, it is not rational with respect to market-wide rules. Hence, the choice is simply between intervention and free-riding. Exerting influence over the content of corporate governance rules may yield positive returns, even in the presence of freeriding activity. Secondly, given that investors cannot easily exit the market, each institution recognizes that if it is not involved in influencing a change, others might do so in a way that harms its interests. Hence, the observed strategy was one of coordinated lobbying for rules that were expected to maximize the joint welfare of institutional investors. The Takeover Code is a good example.[212] Institutional investors were involved at every stage of the drafting of the Code, right from its beginnings as the *Notes*. Because institutional investors have a clear interest in rules that maximize expected gains to shareholders, it is not surprising that the emergence of a pro-shareholder approach to takeover regulation coincided with the emergence of institutional investors as a significant force in British share ownership.

U.K. institutional investors were, in fact, able to go one better than lobbying for their desired rules. They were in many cases able to preempt public regulation entirely by taking charge of enforcement too.[213] Enforcement of private rules is feasible in an environment where parties interact repeatedly, as

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20 (noting that concentrated ownership by insurance companies is, uniquely amongst institutional investors, associated with executive turnover in non-performing companies); *see also* sources cited *supra* note 203.

207. *See generally* STAPLEDON, *supra* note 23, at 56–77; Black & Coffee, *supra* note 6, at 2034–55.

208. *See supra* note 25 and accompanying text.

209. *See supra* notes 22–24 and accompanying text.

210. The U.K. Listing Rules require a shareholder vote to approve "Class 1" transactions, namely those of a value more than 25% of a company's gross assets or profits. U.K. LISTING RULES, *supra* note 25, at 10.5.1. These rules were strengthened following institutional investor lobbying of the London Stock Exchange (then responsible for writing them) in 1978. *See* STAPLEDON, *supra* note 23, at 60.

211. STAPLEDON, *supra* note 23, at 67–76.

212. *See infra* text accompanying notes 231–235.

213. This, of course, also made it easier for the institutions to influence the content of the regulations.

U.K. institutional investors do within the "Square Mile" of the City of London.[214] As repeat players, the institutions were able to agree on a mode of takeover regulation that was much cheaper than litigation, and to threaten reputational sanctions—like exclusion from the market—against those who refused to comply with the Code or Panel rulings. However, as we have seen, the process of establishing the Panel's enforcement procedures needed a kick-start in the form of a credible threat of government intervention.

A reader more familiar with the U.S. story might ask why British managers were so quiet in all of this. Why did they not lobby politicians for more pro-management rules, or push for more active representation in the Working Parties that were responsible for writing first the *Notes* and then the Code? To be sure, the first wave of hostile takeovers in the early 1950s provoked public hostility from corporate managers and trade unions, who denounced individuals like Clore and Samuel as "speculators" intent on the "predatory dismembering" of British businesses solely to "tak[e] out as much cash as possible in the shortest time."[215] Moreover, at this time, institutional investors would have been a much less powerful force. Yet the close links between the government and the Bank of England, on the one hand, and the Bank and City institutions on the other, meant that City voices would have been loud advocates in Ministers' ears for non-interventionist solutions. Furthermore, while a good number of politicians—particularly in the Labour party—sympathized with the popular caricature of the bidder as an "asset stripper" and were pro-intervention, the Labour party's strongly pro-union policies and penchant for nationalization would have led managers to think twice before inviting greater regulation of their affairs from this quarter.

Although managers of listed companies must have felt threatened by the advent of the hostile takeover, they would at the outset have felt that they had powerful allies of the "blue-blood" merchant bankers, to whom their goodwill

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214. It is one of the "folk theorems" of game theory that in the context of an indefinitely repeated game, there are multiple possible equilibria, some of which will induce co-operative behavior in individual rounds. *See, e.g.*, DOUGLAS G. BAIRD, ROBERT H. GERTNER, & RANDALL C. PICKER, GAME THEORY AND THE LAW 172–73 (1994); ERIC RASMUSEN, GAMES AND INFORMATION 123–26 (2d ed. 1994). Where the parties can communicate with one another, then it is possible for them to coordinate on an equilibrium, and they may be expected to select one that is joint welfare enhancing. *See, e.g.*, ROBERT ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBOURS SETTLE DISPUTES 167–83 (1991). This is supported by studies of the norms governing close communities of commercial actors. *See, e.g.*, John Armour & Simon Deakin, *Norms in Private Insolvency: The "London Approach" to the Resolution of Financial Distress*, 1 J. CORP. L. STUD. 21 (2001) (banks involved in debt restructurings in City of London); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001) (contemporary cotton industry participants); ELLICKSON, *supra* at 184–206 (cattle ranchers in Shasta County, California and eighteenth century New England whalers); Avner Greif, *Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders*, 44 J. ECON. HIST. 857 (1989) (eleventh century Maghribi traders); Gillian K. Hadfield, *Delivering Legality on the Internet: Developing Principles for the Private Provision of Commercial Law*, 6 AM. L. & ECON. REV. 154 (2004) (detailing mechanisms for creation of reputations by internet traders).

215. *See, e.g.*, *The Shareholder Today*, ECONOMIST, December 19, 1953, at 903, 903–05.

was important as underwriting clients. It seems that managers' initial tactic was to try, in alliance with this group of bankers, to establish a norm that hostile bids were illegitimate. This pitted them against the growing force of institutional investors in the battle for British Aluminium, an episode that also explains how the institutions took control of the rule-creation process regarding takeovers.

In 1958, the BA board had tried to present its shareholders with a *fait accompli* in the form of a deal with Alcoa, so as to preclude a bid by TI-Reynolds.[216] Shortly after the BA board revealed the Alcoa deal, a group of institutions with large holdings in BA met to discuss their concerns. They resolved, in what was the first public statement along the lines of the board neutrality rule, that it was inappropriate for directors to take steps that would materially affect control of a company—such as issuing large blocks of unissued shares—without shareholder approval.[217] The significance of this is borne out by a comment from *The Times*:

> It is easy to understand why both sides should be anxious to put their views before the institutions. First, it is often left to the institutions to take a view on behalf of the equity holders as a whole; in a complex case of this kind the institutions often become in effect spokesmen for all the shareholders. Secondly, . . . the institutions have a large interest [over 10%] in British Aluminium's Ordinary share capital, so that their votes—as well as their example—must have an important effect on the final result.[218]

So influential were the institutional shareholders becoming that their vigorous condemnation of the BA board's tactics had the immediate effect of eliciting statements from several other companies that the companies would not in the future issue significant blocks of stock without shareholders' consent.[219]

The BA board marshaled its establishment allies to fight back. Its merchant bankers, Hambros and Lazards, were two of the oldest and most "blue-blooded" houses.[220] Together, they persuaded a consortium of leading old-school banks and institutions to enter the fray on BA's behalf, openly seeking to influence the outcome of the dispute, presumably to set a precedent.[221] On New Year's Eve in 1958, in the height of the takeover battle, a syndicate of fourteen City institutions, led by Hambros and Lazards, announced an offer to buy half of any holdings in BA on the condition that investors retain the other half until the

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216. See *supra* text accompanying notes 134–138.

217. *No Early Official Decision on British Aluminium*, TIMES (London), Dec. 5, 1958, at 19.

218. *T.I. Meet the Institutions*, TIMES (London), Dec. 10, 1958, at 16.

219. *How Rise in Credit Sales Has Been Financed: British Aluminium Reply*, TIMES (London), Dec. 16, 1958, at 12.

220. *See* RON CHERNOW, THE WARBURGS: A FAMILY SAGA 648 (1993); DAVID FARRER, THE WARBURGS 180 (1975); JOSEPH WECHSBERG, THE MERCHANT BANKERS 72–74 (1966).

221. A precedent may already have existed. There is some suggestion that a similar sort of tactic was used, far more discreetly, in the Savoy Hotel battle six years earlier (discussed *supra* text accompanying notes 127–133) to buy off the hostile bidder. *See* BULL & VICE, *supra* note 123, at 59.

TI-Reynolds bid had lapsed.[222] They claimed to have the backing, in secret, of "many large banking institutions and financial concerns,"[223] and to have received assurances from the holders of about twenty percent of BA's stock that they would not accept the TI-Reynolds bid.[224] The syndicate urged shareholders—and in particular, institutional investors—to support their cause on grounds of "national interest," alleging that the Alcoa deal was the only way that BA could remain in British hands.[225]

The syndicate's offer led to an outbreak of open sparring within the normally closed ranks of the City's banking community. It appeared to many that the old-school merchant banks were flexing their muscles in an unseemly fashion in order to protect the perceived interests of their clients—the BA managers.[226] Those same managers, in the eyes of many institutional investors, had acted with disregard to the shareholders' interests. TI and Reynolds were advised by Helbert Wagg and S.G. Warburg & Co. The latter had been recently founded by Siegmund Warburg, one of the few merchant bankers of the time willing to dirty his hands with hostile bids, and regarded by many in the City's establishment as an upstart arriviste.[227] His clients responded aggressively to the syndicate's offer: they upped their bid while at the same time buying BA's shares vigorously in the market.[228] Institutional shareholders sold to them *en masse*. The whole affair was a very public and expensive humiliation for the members of the City syndicate, who found themselves minority stockholders in a business controlled by TI-Reynolds.

The battle for British Aluminium defused any willingness in the City's old guard to push a pro-management agenda because they realized the syndicate's opposition had been an expensive mistake and the institutional shareholders were now a force to be reckoned with. Institutions' fiduciary duties to their beneficiaries meant that they were much more likely just to "follow the money" than wealthy individual shareholders, who might be subject to persuasion by

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222. *See British Aluminium: Long Knives Out*, ECONOMIST, Jan. 3, 1959, at 62; *Cash Bid for Aluminium: Intervention by City Group*, TIMES (London), Jan. 1, 1959, at 8; *New Move in Battle for British Aluminium*, TIMES (London), Dec. 31, 1958, at 13. The syndicate also comprised Lonsdale & Co.; the British South Africa Company; Brown, Shipley & Co.; Cables Investment Trust; Robert Fleming, Guinness; Mahon & Co.; the Locana Corporation; Samuel Montagu & Co.; Morgan Grenfell & Co.; M. Samuel & Co.; Edward de Stein & Co.; and the Whitehall Trust. *See Cash Bid for Aluminium*, *supra*.

223. *Letters to the Editor: Views on British Aluminum*, TIMES (London), Jan. 12, 1959, at 9 (letter from Mr. Olaf Hambro, Chairman of Hambros Bank Limited, about the affair).

224. *City Group's Scheme for British Aluminium*, TIMES (London), Jan. 1, 1959, at 13.

225. *Cash Bid for Aluminium*, *supra* note 222.

226. *See War to What Purpose?*, ECONOMIST, Jan. 10, 1959, at 145, 147; STAMP & MARLEY, *supra* note 120, at 7–8.

227. *See* FARRER, *supra* note 220, at 181 (describing Warburg as "unloved and unknown"); CHERNOW, *supra* note 220, at 647 (describing Warburg as "arriviste and enfant terrible").

228. *New Phase in the British Aluminium Dispute: Moves at Bank of England*, TIMES (London), Jan. 2, 1959, at 12; *T.I.-Reynolds Own Third of British Aluminium*, TIMES (London), Jan. 3, 1959, at 11; *Tube Investments Add £2,250,000 to Aluminium Shares Offer*, TIMES (London), Jan. 5, 1959, at 8; *Reynolds Buys More British Aluminium Shares*, TIMES (London), Jan. 6, 1959, at 8.

establishment links.[229] Merchant banks that had previously adopted a pro-management stance might have had cause to reflect on the increasing importance to their underwriting business of good relations with institutions, and realized that indeed there was much to be lost through antagonizing them.[230] Moreover, there was plenty of money to be made through advising on acquisitions.

The institutional shareholders capitalized on the moral advantage given to them by the BA affair by seeking to crystallize the norm of board neutrality. A statement was issued by the Association of Investment Trusts, with the support of the British Insurance Association, that in their view "[i]t is wrong for directors to allow any change in control or the nature of the business without referring to shareholders."[231] *The Times* thought views were becoming sufficiently unified that it was possible to opine in the summer of 1959 that "the broad code of business ethics applicable [to takeovers] will soon come to be generally recognized."[232]

Shortly afterwards, when the Bank of England convened its Working Party for the drafting of the *Notes*, the groups represented were institutional investors, merchant banks and finance houses.[233] Neither of the major contemporary management organizations, the Institute of Directors or the Association of British Chambers of Commerce, was involved in the principal deliberations.[234] It seems most likely that this was simply because these were not "City" organizations, and so the Bank was unable to approach them informally and in secret. With any resistance from old-school merchant banks subdued, the institutions were able simply to translate their statement of policy, expressed in the heat of the British Aluminium battle, into the *Notes* that came to represent what was regarded as "fair play" in the conduct of takeover bids.

When the trade associations that had drafted the *Notes* were reconvened by the Bank of England nine years later for the Takeover Code, the Confederation of British Industry, another management organization, was invited to participate in the drafting process.[235] However, by then, management opposition to the idea of hostile takeovers had waned dramatically. Starting in the 1960s, bids were

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229. *See* BULL & VICE, *supra* note 123, at 65–66.

230. The affair also sealed S.G. Warburg's reputation as the preeminent advisor for hostile bidders. CHERNOW, *supra* note 220, at 653; FARRER, *supra* note 220, at 182.

231. *Consulting Shareholders: The Institutions' Views*, TIMES (London), Feb. 11, 1959, at 15.

232. Editorial, *Top-Hat Take-Overs*, TIMES (London), June 19, 1959, at 13.

233. Those involved were the Issuing Houses Association, the Accepting Houses Committee, the Association of Investment Trusts, the British Insurance Association, the Committee of London Clearing Bankers, and the London Stock Exchange. *Queensberry Rules for Bids*, ECONOMIST, Oct. 31, 1959, at 440, 440.

234. *Rules for Take-Overs?*, ECONOMIST, Oct. 17, 1959, at 270 (not listing either of the major contemporary organizations as taking part in the initial discussions). Both did, however, set up committees to coordinate their response to the issue of takeover bids. *Under Scrutiny*, ECONOMIST, Oct. 24, 1959, at 358, 358.

235. The Working Party for the *City Code* comprised the same institutions that had participated in the drafting of the *Notes*, with the addition of representatives of the National Association of Pension

driven by consolidation, and managers were just as likely to be bidders as targets in this milieu.[236] No serious opposition has since been raised to the idea of the board neutrality rule.

C. LEGISLATION AND COURTS: THE CASE OF THE UNITED STATES

To understand why one finds neither institutional shareholders nor self-regulation at the heart of U.S. takeover regulation, we should begin by revisiting the enactment of the Securities Acts of 1933 and 1934. The Securities Acts established a new system of disclosure and antifraud regulation, and for establishing the SEC to police the American securities markets. As an accidental consequence of the New Dealers' quite conscious housekeeping, the Securities Acts laid the groundwork for a judicial rather than self-regulatory mode of takeover regulation.

Until the 1930s, the nation's de facto market regulator was the New York Stock Exchange. Paul Mahoney has written,

> By 1934, the NYSE had for many years required listed companies to provide stockholders with a balance sheet and income statement in advance of each annual meeting. By 1928, the annual financial statements had to be audited by an independent auditor. Beginning in the early 1920s, the Exchange began to push for companies to agree to quarterly reporting, and such undertakings were already common in listing agreements by the mid-1920s.[237]

Although the New York Stock Exchange was a private entity—a "private club" in William Douglas's dismissive term[238]—most of the nation's largest corporations were listed on the exchange. The NYSE listing rules thus served as a form of industry self-regulation similar in many respects (though different in others, as we shall see)[239] to the current strategy for regulating takeovers in the United Kingdom.

The New Deal reformers believed that the NYSE's regulatory efforts were inadequate—that more disclosure was needed and that the NYSE too often looked the other way when companies failed to honor the existing rules (similar criticisms to those that would be laid against the first incarnation of the Takeover Panel in 1968).[240] Because of this, and as part of their larger campaign to minimize the influence of Wall Street insiders in American corporate gover-

Funds and the Confederation of British Industry. *See Issuing Houses Prepare Code*, TIMES (London), July 22, 1967, at 15; TAKEOVER PANEL, 1969 REPORT, *supra* note 154, at 2.

236. *See* BULL & VICE, *supra* note 123, at 13–14.

237. Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1466 (1997). For a much more critical account of NYSE self regulation, see Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 795–97 (2006).

238. WILLIAM O. DOUGLAS, DEMOCRACY AND FINANCE 65 (1940).

239. *See infra* text accompanying notes 271–274 (discussing limitations of NYSE as a self-regulator).

240. *See supra* notes 158–159 and accompanying text.

nance, the reformers quite consciously wrested oversight authority away from the Exchange and enshrined it in the Securities Acts and the rules promulgated by the SEC. This meant that the primary source of securities regulation would be mandatory federal oversight by Congress and the SEC, rather than ongoing self-regulatory adjustments of the sort we see in the United Kingdom.[241]

The Securities Acts also had a subtler, geographical effect. One of the factors that has made self-regulation effective in the United Kingdom, as we have seen, is the fact that all of the major players are located in close proximity to one another in the City, London's ancient business district. This makes the temporary "secondments" used to staff the Panel much simpler than if the banks and institutions were scattered throughout the country, and it means that the bankers and institutional shareholders rub shoulders on a daily basis.

Although America's financial institutions have always been more widely flung than their U.K. counterparts, until the 1930s the largest players were concentrated on Wall Street. So long as stock exchange officials, J.P. Morgan and the other investment banks, and most of the largest shareholders all walked the same streets of lower Manhattan, it was conceivable that informal rules for takeovers might have developed in the 1950s or 1960s—or indeed, that lawmakers might have pressured shareholders and the exchanges to develop informal rules, as the Bank of England did in the United Kingdom.[242] But the Securities Acts added Washington, D.C. to the regulatory map, thus making it impossible to replicate the geographical proximity that characterizes corporate governance in the United Kingdom. In the United States, visiting all of the relevant players would require trips to Wall Street, Washington and—because directors' fiduciary duties are still regulated by the states—Wilmington and Dover, Delaware.

The lack of institutional investor influence in the United States meant that although the emergence of hostile tender offers in the late 1950s took corporate America by storm, just as in the United Kingdom, the political and regulatory dynamics could not have been more different. When Senator Williams introduced the legislation that eventually became the Williams Act in 1965, his principal concern was not the use of questionable defenses by target managers. It was "corporate raiders," the "white collar pirates" who were assaulting "proud old companies" and stripping them down to "corporate shells" by

241. For a description of the powers the Securities Exchange Act of 1934 gave the SEC over the New York Stock Exchange and the other exchanges, see, for example, Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 92 (2005) (describing power "to abrogate and amend [NYSE] rules," as well as additional powers given to the SEC in 1975). Interestingly, William Douglas favored direct, coerced self-regulation of U.S. business under "a federal agency with the mandate to regulate large multinational corporations by directing their governance." *Id.* at 133. But Congress never established the additional agency he envisioned.

242. Note that an informal "Gentleman's Code" discouraged white shoe investment banks from participating in hostile takeovers in the United States in the 1960s. This may suggest the importance of an external government prod, rather than self-regulation alone; it also reinforces the point that it is important to have all of the shareholder groups at the table, not just one—the investment banks.

"trad[ing] away the best assets" and keeping "the loot" for themselves.[243] Senator Williams candidly acknowledged his desire to assure that corporate managers had ample time to mobilize their opposition to a takeover threat. In a 1967 hearing on a revised version of the bill, Senator Kuchel, who co-sponsored the legislation with Senator Williams, sounded the same themes. "Today," he complained, "there are those individuals in our financial community who seek to reduce our proudest businesses into nothing but corporate shells. They seize control of the corporation with unknown sources, sell or trade away the best assets, and later split up the remains among themselves."[244] A favorite illustration of these dangers was a bid for Columbia Motion Pictures, "an organization renowned for its significant contribution to the entertainment industry."[245] In late 1966, a French bank had made a tender offer for a sizeable minority stake of Columbia, allegedly as part of a plan to join forces with a group of dissident shareholders to take control. The French bank disguised both its identity and its intentions. "If this attempt had succeeded," according to Senator Kuchel, "Columbia would have found itself under the control of a combination including significant foreign interests, without prior notice to the company, without an opportunity for examination into the circumstances surrounding the tender offer, and without any regard for the rights of its stockholders."[246]

One might have expected the principal opposition to the proposed legislation to come from institutional shareholders such as pension funds and insurance companies whose stock holdings benefited from the premium prices paid by takeover bidders. Clamping down on tender offers would mean fewer takeover premiums. But one searches the legislative history in vain for evidence that institutional shareholders entered the legislative fray. The SEC testified repeatedly, and indeed seems to have helped Senator Williams to shape the legislation. Representatives of the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers also testified, as did the Investment Bankers Association of America.[247] Even law and business professors testified.[248] But not one representative of a pension fund, insurance

243. 111 CONG. REC. 28, 257 (statement of Sen. Williams). *See also* Eileen Shanahan, *Senator Seeking Take-Over Curbs*, N.Y. TIMES, Oct. 25, 1965, at 57 (describing Williams's bill as "designed to help prevent 'corporate raiding'").

244. *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Comm. on Banking and Currency*, 90th Cong. 43 (1967) [hereinafter *1967 Senate Hearing*] (statement of Sen. Kuchel).

245. *Id.*

246. *Id.* "Fortunately," Kuchel concluded, "the threat of takeover . . . was resolved by a private agreement between the parties. But such agreements offer little assurance that similar future attempts at such secretive attempted takeovers will not succeed." *Id.*

247. The exchanges were generally sympathetic to the legislation, but criticized the proposal for prior notification and suggested the shareholder withdrawal rights and right to pro rata treatment should be limited to the first ten days of an offer. *See, e.g.*, *1967 Senate Hearing*, *supra* note 244, at 73–77 (statement of Donald L. Calvin, Vice President, New York Stock Exchange).

248. All of the professors criticized the bill, and most argued that tender offers appeared to be beneficial and should be encouraged rather than chilled. *See, e.g.*, *id.*, at 114–28 (statements of Stanley

company or other institutional shareholder took the microphone to offer the perspective of shareholders on the proposed legislation.[249]

Shareholders' silence surely reflected the fact that, during the same period as U.K. tax and dividend policy spurred institutional stock ownership, the share of U.S. stock held by institutions remained relatively small. Shareholder voice may also have been chilled by the knowledge that American lawmakers historically got nervous when financial institutions flexed their muscles on corporate governance issues.[250]

As a result, the interests of shareholders were represented not by shareholders themselves, but by the SEC. The SEC's mantra throughout was "neutrality" between bidders and target managers. As SEC Chairman Manuel Cohen put it,

> [T]he principal point is that we are not concerned with assisting or hurting either side. We are concerned with the investor who today is just a pawn in a form of industrial warfare. And that is all the argument today is: Do you help one side, or do you help the other side? The investor is lost somewhere in the middle. This is our concern and our only concern.[251]

As a result of the SEC's plea for a less lopsided antitakeover bill, Senator Williams adjusted the proposed legislation to shorten the pre-solicitation disclosure period to five days, and to give the SEC authority over target managers' missives against a takeover bid, as well as over the bidder's solicitations.[252] The SEC did not ask for, nor did it receive, more extensive powers to regulate

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A. Kaplan, Professor of Law, University of Chicago; Robert H. Mundheim, Professor of Law, University of Pennsylvania; William H. Painter, Professor of Law, University of Missouri at Kansas City). A focal point of their testimony was a study of tender offers by Samuel Hays and Russell Taussig. Contrary to Senator Williams's charges that raiders were denuding proud American companies, Hays and Taussig found that most bidders did not sell off major assets after an acquisition. *Id.* at 53–55 (statement of Samuel L. Hays, III, Professor of Finance, Graduate School of Business, Columbia University); Samuel L. Hays, III & Russell A. Taussig, *Tactics of Cash Takeover Bids—For Bidders, Incumbent Managements, and Shareholders*, HARV. BUS. REV., Mar.–Apr. 1967, at 135, 138.

249. Almost the only evidence of participation by banks or other institutions is a letter from the American Bankers Association suggesting that the legislation be adjusted to make clear that banking regulators rather than the SEC would have authority over publicly held banks. Letter from American Bankers Association to Senator Harrison Williams (Apr. 10, 1967), *in 1967 Senate Hearing*, *supra* note 244, at 238. A number of letters from corporate managers and business trade groups are reprinted in the appendix to the 1967 hearings, each applauding the decision to regulate takeover bidders. *See, e.g.*, Letter from J.O. Larson, President, American Society of Corporate Secretaries, Inc., to Senate Committee on Banking and Currency (Apr. 20, 1967), *in id.* at 238–39 (stating that the "Society believes that the information requirements are both desirable and reasonable"); Letter from Holly Sugar Corp. to Senator Harrison Williams (Apr. 14, 1967), *in id.* at 244 (stating that "in an industry charged with a responsibility for production and marketing of our nation's sugar, not only the shareholders . . . and the Securities and Exchange Commission, but also the Federal Government agencies responsible for administering the Sugar Act should, at least, have the opportunity of learning the identities and intentions of outside groups that are seeking control of sugar producers").

250. *See, e.g.*, ROE, *supra* note 6, at 28–32.

251. *1967 Senate Hearing,* supra note 244, at 178 (statement of Manuel Cohen, Chairman, Securities & Exchange Commission).

252. *See* Note, *supra* note 104, at 381 n.28.

takeovers, such as the power to assess the merits of a takeover bid.[253] This diffidence seems to have reflected a perception that the SEC's authority was limited to ensuring adequate disclosure and after-the-fact policing of fraud, another legacy of the New Deal package of reforms.[254] This meant that all of the regulatory gaps would be left to common law development as part of the evolving law of directorial duties in the Delaware state courts.[255]

Because the self-regulatory option had long been foreclosed and the SEC's role was limited to policing disclosure, the most significant aspects of U.S. takeover regulation were shaped by Delaware judges. As we shall see, this judicialization of U.S. takeover regulation made it easier for a pro-manager approach to emerge. Judge-made law represents the accumulation of earlier precedents. However, the process of establishing precedents is necessarily reactive, rather than proactive, because judges can only decide cases which are brought before them. The structure of precedents may therefore be influenced by the ability or willingness of particular types of parties to litigate certain types of dispute.[256] The decision to litigate acts as a filter for the evolution of common law rules—or, to put it another way, it represents the "demand side" of common law judicial rulemaking.[257]

As compared with less incremental modes of rulemaking—such as legisla-

253. The SEC's only request was that it be given "more flexible authority to administer" the provisions included in the proposed legislation. *See, e.g.*, Eileen Shanahan, *S.E.C. Seeking Stock 'Warfare' Rules*, N.Y. TIMES, Mar. 22, 1967, at 61 (describing Cohen testimony).

254. Interestingly, the year after the Williams Act was enacted and Cohen had stepped down from the SEC, he characterized the Williams Act as "obsolete" and "inadequate," and argued that the SEC be given the authority to "set standards of conduct to regulate conglomerate financial statements and debt-to-equity ratios 'so that [the Commission] does not have to rely on proving a fraud after the event.'" SELIGMAN, *supra* note 101, at 432 (alteration in original). Seligman suggests that these statements reflect Cohen's real views, views he was reluctant to express when he "had the burden of husbanding the SEC's political resources [and] of speaking for his relatively more conservative fellow commissioners." *Id.*

255. We do not mean to suggest that that SEC regulation would have led to a truly pro-shareholder approach to takeover regulation. SEC regulation almost certainly would have chilled some takeovers, and the SEC's stance would have been linked more closely to political dynamics in Washington than to maximizing shareholder choice.

256. For a review of the literature, see Paul H. Rubin, *Micro and Macro Legal Efficiency: Supply and Demand*, 13 SUPREME COURT ECON. REV. 19, 21–27 (2005).

257. To be sure, in an environment characterized by regulatory competition, judges will have systematic incentives to favor parties who make the choice to litigate. Where the choice is made by both parties (for example, contractual choice of law) then these incentives may be efficient. Where it is systematically made by one party (for example, tort law), then the incentives will be inefficient: see generally Todd J. Zywicki, *The Rise and Fall of Efficiency in the Common Law: A Supply-Side Analysis*, 97 NW. U. L. REV. 1551 (2003) (exploring efficiency in the common law using the supply-side and demand-side models). For the classic supply-side, interest group account of Delaware corporate law, see Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987). Bebchuk argues that a supply-side mechanism is primarily responsible for the manager friendliness of U.S. takeover law as compared with its U.K. counterpart. *See* discussion *supra* note 3. In contrast, our explanation focuses on the demand side, and shows that in relation to the United Kingdom's *common law*, where similar demand-side circumstances prevail, the results are substantially similar to those in the United States. *See infra* text accompanying notes 263–270.

tion, or self-regulation, case law precedents are relatively free from interest group influences. An interest group wishing to change the law through litigation must not only agree on the preferred rule, but must also coordinate over time on choosing suitable test cases and in overcoming barriers to intervening in private disputes.[258] So it would have been more difficult for U.S. institutional investors, even had they been as well-organized, to have influenced the production of takeover regulation by Delaware courts than it was for their U.K. counterparts to do so within a self-regulatory framework.

This is not to say that the production of judicial precedents is entirely free from bias towards private interests. To be sure, if all parties have equal access to funding, and equal likelihood of being involved in future litigation, inefficient rules may be expected to be litigated more frequently than efficient ones, as they will impose greater costs on one or both parties.[259] Under such ideal circumstances, the common law would exhibit a tendency to evolve towards rules that promote social welfare. But this optimistic assessment does not hold if one type of litigant has a systematically greater incentive or ability to litigate.[260] For example, a repeat player will be able to internalize the future benefits of a favorable precedent, and so will have a greater incentive to litigate than a one-shot player.[261] The characteristic difference of precedent from regulation or legislation, then, is not so much the absence of private interests, but the way in which these interests are mediated into the rule production process. The higher costs of coordinating to bring litigation—as compared to lobbying for legislative change—mean that for judge-made law, the interests of individual litigants (or populations of litigants) are relatively more important than those of coordinated groups for the production of rules.

Who, then, are the likely litigants in takeover disputes? The defendants will be the target board. While protections such as D&O insurance and golden parachutes often counteract the financial risks, respectively, of personal liability and loss of employment, boards still face significant reputational costs (that is, depreciation of their human capital consequent upon defeat) if they lose a takeover lawsuit, which are far more difficult to insure. At the same time, because they are able to draw upon corporate resources, boards have deep

258. These include the rules on maintenance and champerty.

259. *See* John C. Goodman, *An Economic Theory of the Evolution of the Common Law*, 7 J. LEGAL STUD. 393, 393 (1979); George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65, 65 (1977).

260. Martin J. Bailey & Paul H. Rubin, *A Positive Theory of Legal Change*, 14 INT'L REV. L. & ECON. 467, 472–73 (1994); Jack Hirschleifer, *Evolutionary Models in Economics and Law*, *in* 4 RESEARCH IN LAW AND ECONOMICS 1 (Paul H. Rubin & Richard Zerbe eds., 1982); Paul H. Rubin, *Common Law and Statute Law*, 11 J. LEGAL STUD. 205, 211 (1982). Similar results can follow where one group of litigants is systematically better informed about the likely outcome of litigation. *See* Keith N. Hylton, *Information, Litigation, and Common Law Evolution*, 8 AM. L. & ECON. REV. 33, 44–46 (2006).

261. *See* Bailey & Rubin, *supra* note 260, at 476; Avery Katz, *Judicial Decisionmaking and Litigation Expenditure*, 8 INT'L REV. L. & ECON. 127 (1988).

pockets. This has two implications: first, that boards are likely to be willing to pay over the odds to settle cases; and secondly, that they will defend aggressively the cases that do go to trial. The target board can settle a stockholder suit for damages, but they cannot do so easily where a jilted bidder seeks an injunction. Most precedents on target boards' duties have therefore resulted from cases where an injunction is sought.

The bidder's financial interest lies in the gains to be realized from successfully gaining control of the target company, which an injunction may achieve by forcing the target board to drop a defense. Yet an acquirer who succeeds in proving that the board's defensive tactics are illegitimate will not necessarily capture all of the economic benefits of the judicial ruling. There is nothing to stop a second bidder from free-riding on the plaintiff's efforts and then swooping in on the now-defenseless target company with a higher offer. Given this possibility, the bidder will discount the likely benefits from bringing a lawsuit accordingly; as a result, bidders may tend to pursue litigation only in comparatively egregious cases. It may also be the case that the nature of the judicial process in fiduciary duty cases, which focuses on an exchange of narratives by the two sides, tends subtly to favor target managers, since their argument that they need to resist the unwanted takeover in order to preserve order and stability will often resonate with a common law judge. The resulting judge-made law may therefore exhibit a pro-management quality.[262]

We should be clear that this analysis is not a criticism of Delaware law or the civil procedure in the United States more generally. Rather, it is a general proposition that follows from the use of common law adjudication to govern in this particular context. To see the generality of the point, we need only recross the Atlantic and consider the common law treatment of takeovers in the United Kingdom. As we have seen, judicial oversight of U.K. takeovers was sharply curtailed by the introduction of the Takeover Code in 1968. But the judicial precedents that had developed up to and shortly after that point bear a striking resemblance to several of the leading Delaware takeover decisions.

The U.K. common law position on takeover defenses was principally developed by a series of cases in the 1960s and early 1970s.[263] As in the United States, most were actions by bidders seeking injunctions. They generally held that directors cannot take actions that have the primary purpose of preserving their own control of the company or of altering the balance of power in the

262. John Coffee made a claim somewhat similar to our last point in his early work on derivative and class action litigation. Coffee argues that judicial precedents will exhibit a pro-management bias owing to judges' unwillingness to impose multi-million dollar liabilities on directors where their conduct is not morally reprehensible. *See* Coffee, *supra* note 9, at 1150 & n.9; John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Reform*, 81 COLUM. L. REV. 261, 316–18 (1981).

263. *See generally* Howard Smith Ltd. v. Ampol Petroleum Ltd. [1974] A.C. 821 (P.C. 1974) (a case relating to facts occurring in Australia and heard in the United Kingdom before the Privy Council, then the highest court of appeal in that jurisdiction); Bamford v. Bamford [1970] Ch. 212; Hogg v. Cramphorn Ltd. [1967] Ch. 254.

shareholders' meeting.[264] Yet the jurisprudence also made clear that actions that were motivated primarily by a legitimate business purpose, and had a merely incidental effect of frustrating a bid, would not constitute a breach of duty.[265] In interpreting these statements, it is worth bearing in mind that the facts in the litigated cases were quite extreme. Most involved the issue of fresh shares to dilute the holding of an acquirer *after* voting control of the target had been secured (which would surely be a breach of duty under Delaware law too).[266] Had the directors acted with greater alacrity, before the bidder had secured control, it would have been more difficult to argue that they were interfering with the control of the general meeting. This would be particularly so if they formed the opinion, and could point to supporting evidence, that the bidder's plans for their company were not in its interests. Sir Robert Megarry, V.C. made this point expressly in the later case of *Cayne v. Global Natural Resources plc*:

> If company A and company B are in business competition, and company A acquires a large holding of shares in company B with the object of running company B down so as to lessen its competition, I would have thought that the directors of company B might well come to the honest conclusion that it was contrary to the best interests of company B to allow company A to effect its purpose, and that in fact this would be so. If, then, the directors issue further shares in company B in order to maintain their control of company B for the purpose of defeating company A's plans and continuing company B in competition with company A. I cannot see why that should not be a perfectly proper exercise of the fiduciary powers of the directors of company B. The object is not to retain control as such, but to prevent company B from being reduced to impotence and beggary, and the only means available to the directors for achieving this purpose is to retain control. This is quite different from directors seeking to retain control because they think that they are better directors than their rivals would be. . . .[267]

264. *Howard Smith*, [1974] A.C. at 834–38.

265. Two Commonwealth decisions were cited by the Privy Council in *Howard Smith* as examples. *See* Teck Corp. v. Millar (1972) 33 D.L.R. (3d) 288, 328, 331 (Supreme Court of British Columbia) ("lock-up" deal involving issue of shares to counterparty found to have been effected with primary purpose of securing for company most favorable terms for deal and therefore legitimate, notwithstanding that it had the necessary consequence of frustrating hostile acquisition); Harlowe Nominees Pty Ltd. v. Woodside (Lakes Entrance) Oil Co. (1968) 121 C.L.R. 483 (Austl.) (primary purpose of issuing shares was business purpose of raising capital; the legitimate purpose notwithstanding it had necessary effect of diluting hostile acquirer's holding).

266. In Delaware, analogous maneuvers have long been struck down under a series of cases prohibiting managers from interfering with insurgents' voting rights. *See, e.g.*, MM Companies, Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1126, 1132 (Del. 2003) (managers increased board size to impede shareholder vote); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 655, 663 (Del. Ch. 1988) (same); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439–40 (1971) (shareholder meeting date moved up to interfere with vote).

267. Criterion Props. plc v. Stratford U.K. Props. LLC, [2002] EWCA (Civ) 1783, [2003] 1 W.L.R. 2108 (quoting Cayne v. Global Res. plc (unreported decision of Sir Robert Megarry, V.C., Aug. 12, 1982, *aff'd on other grounds*, [1984] 1 All E.R. 225)).

This formulation does not seem substantially different from the "just say no" defense that some observers believe has been accorded to directors under Delaware law since *Time Warner*.[268]

These issues were recently considered again by the English Court of Appeal in the context of a very onerous lock-up agreement.[269] Lord Justice Carnwath, who gave the leading judgment, suggested that a lock-up might be justifiable in the face of a hostile acquirer who threatened the company's existing business, but felt that the arrangement in question was disproportionate in its response to the perceived threat: it took effect not just in relation to the particular bidder, but in relation to any change in the management of the company.[270] In other words, it smacked of entrenchment. This formulation is strikingly similar to the proportionality test employed by Delaware courts in reviewing directors' conduct under *Unocal*.

Given that using litigation to resolve such matters involves a structural bias in favor of the directors, it should not be surprising that U.K. institutional investors chose to "privatize" the matter by instituting the Takeover Code in the late 60s. What is surprising, however, is that their counterparts in the United States did not. This, as we have explained, is a result of federal legislation which prevented institutional investors from developing sufficiently close links with one another to make collective action on this scale feasible in the United States, together with federal regulation that displaced an earlier tradition of self-regulation in the securities markets. There is an irony, therefore, in calls for federal legislation to remedy the perceived "problem" of Delaware takeover law: in our view, it is federal legislation that is fundamentally responsible for the perceived problem.

IV. LESSONS AND IMPLICATIONS

Our analysis has shown that the starkly different approaches to takeover regulation in the United States and United Kingdom have been influenced by their characteristic modes of rule-production: courts have been the principal regulators in the United States, whereas self-regulation shaped by institutional shareholders prevails in the United Kingdom. In each case, the regulatory mode was the largely unintended consequence of regulation designed to achieve other objectives. In the United States, the securities laws displaced existing self-

268. *See* Blanaid Clarke, *Regulating Poison Pills,* 4 J. CORP. L. STUD. 51, 61–67 (2004); Paul L. Davies, *The Regulation of Defensive Tactics in the United Kingdom and the United States*, *in* EUROPEAN TAKEOVERS: LAW AND PRACTICE 195, 207–10 (Klaus Hopt & Eddy Wymeersch eds., 1992); *cf* David Kershaw, *The Illusion of Importance: Reconsidering the UK's Takeover Defence Prohibition*, 56 INT'L & COMP. L.Q. 267, 282–289 (arguing that U.K. fiduciary doctrine is more restrictive).

269. It was referred to in the case as a "poison pill," but in form it was closer to the arrangements known as "lock-ups" in the United States.

270. Criterion Props. plc v. Stratford U.K. Props. LLC, [2002] EWCA (Civ) 1783, [2003] 1 W.L.R. 2108. The case was appealed to the House of Lords, which affirmed it on different grounds. *See* [2004] UKHL 28, [2004] 1 W.L.R. 1846, 1847.

regulation, and financial services legislation curbed institutional ownership of stock. In the United Kingdom, a postwar tax environment that favored collective over individual, shareholding coupled with a political tolerance of self-regulation thrust institutions into the center of corporate governance.

In this part, we consider two questions that emerge from our historical and institutional analysis. First, do our findings suggest that self-regulation is generally preferable to judicial or regulatory oversight? Second, what are the future prospects for the United Kingdom and United States regimes? Does the increasing ownership of U.K. stock by non-British investors and the advent of the European Union's Takeover Directive call into question the future of the Panel's oversight? At the same time, does the recent rise to prominence of institutional shareholders in the United States mean that a more shareholder-oriented regime is likely to emerge?

A. THE CHOICE BETWEEN SELF-REGULATION AND OTHER REGULATORY STRATEGIES

Given the efficacy of the Takeover Code, it may be tempting to conclude that self-regulation is always an optimal regulatory strategy. But this would be a mistake. The effectiveness of self-regulation is closely tied to the incentives of the individuals and entities that are providing the rules. If the regulators' incentives are consistent with social welfare, self-regulation can work extremely well—and indeed, in an area characterized by rapid change, may prove far superior to legislative or judicial oversight. If their incentives diverge, on the other hand, self-regulation is much less attractive.

Two examples from the corporate and securities law context will make these intuitions more concrete. The first involves the U.S. stock exchanges, which are treated as self-regulatory organizations under the U.S. securities laws. As discussed earlier, until the 1930s, rules written by the New York Stock Exchange were the principal source of U.S. securities regulation.[271] The brokers and dealers who ran the exchange had an obvious interest in a vibrant securities market since this strengthened the exchange and maximized their trading opportunities. But their incentives were, at best, imperfectly congruent with the objective of assuring vigorous, efficient corporate governance. Even under the post-New Deal structure, which shifted control from traders and specialists to member-brokers, the NYSE's self-regulatory incentives are a very noisy proxy for the best interests of the shareholders of listing companies.[272] Brokers may have an interest in chilling takeovers if the target is listed on the exchange, even if takeovers are generally efficient, since the takeover may mean one less

271. *See supra* text accompanying notes 237–241.

272. Until it was forced by the New Deal SEC to reform its governance structure, the NYSE "was dominated by floor traders and specialists who traded largely for their own accounts." SELIGMAN, *supra* note 101, at 166. Because traders and specialists profit from buying and selling stock as part of their responsibility for assuring continuous, liquid trading, they might actually prefer an inadequate level of corporate disclosure; the opacity could enhance the importance of their role and create more opportunities for profitable trading.

company listed on the exchange.[273] The NYSE and other exchanges also have a strong interest in keeping important listed firms happy, even if the firm's happiness comes at the expense of effective corporate governance. The NYSE was famously unwilling to stand up to GM, for instance, when GM threatened to bolt if the NYSE tried to prohibit its use of stock with differential voting rights.[274]

Second, recent concerns about the misbehavior of hedge funds have prompted a wide-ranging debate about whether reform is necessary, and if so, what shape the reform should take.[275] One proposal calls for the SEC to pressure the hedge fund industry to devise a set of "best practices" designed "to reduce the incidence of fraud through establishing a custom of greater disclosure and transparency to investors."[276] While the threat of more sweeping federal regulation has indeed prompted a newfound interest within the hedge fund industry to provide meaningful information to potential investors,[277] the hedge funds' incentives to self regulate seem poorly aligned with the best interests of ordinary investors. Some of the strategies used by hedge funds are beneficial to the market—hedge fund arbitrage improves liquidity and the accuracy of market pricing, for instance—but hedge funds also benefit from strategies (such as the late trading and market timing practices that gave rise to the recent mutual fund scandals) that divert value from other investors. Under these conditions, proposals for self-regulation by the industry itself as a substitute for formal regulation need to be viewed with caution.

The incentives of the institutional investors and banks that oversee U.K. takeover regulation are not perfect, either. Institutional shareholders are, as the name suggests, institutions rather than private individuals. Like the companies they invest in and monitor, the decisions of institutional shareholders are made by agents whose own incentives may be skewed in various ways. They may be affected by political considerations rather than purely economic ones, for

273. Brokers have an even more direct interest in their own fees. The NYSE imposed monopoly-like fixed-rate pricing on brokers' fees until 1975, when the SEC forced the NYSE to eliminate the requirement, a development known as the "Big Bang." *See, e.g.*, SKEEL, *supra* note 59, at 169 (describing the Big Bang).

274. The stock exchanges' reluctance to impose discipline has been magnified by the increasing competition among exchanges. In the early twentieth century, when a U.S. company that wished to be publicly traded needed to list on the NYSE, the threat of delisting was a powerful stick. Now, a company could respond by simply listing on another exchange. *See, e.g.*, Marcel Kahan, *Some Problems with Stock Exchange-Based Securities Regulation: A Comment on Mahoney*, 83 VA. L. REV. 1509, 1510, 1514 n.30 (1997) (describing the NYSE's reluctance to enforce its one-share one-vote requirement for fear it would lose listings to NASDAQ or AMEX).

275. In 2005, the SEC promulgated a rule that required most hedge fund advisors to register with the SEC by February 2006. *See, e.g.*, Gregory Zuckerman, *Hedge Funds Brace for Regulation*, WALL ST. J., June 8, 2005, at C1. The rule was recently struck down by the D.C. Circuit, and it is unclear whether the SEC will try to regulate in other ways in the absence of explicit authority from Congress.

276. Erik J. Gruepner, Comment, *Hedge Funds are Headed Down-Market: A Call for Increased Regulation?*, 40 SAN DIEGO L. REV. 1555, 1596 (2003).

277. *See, e.g.*, *id.* at 1595 ("The hedge fund industry has already demonstrated its desire to prove that it does not need increased regulation through distributing best practices recommendations.").

instance.[278] But overall, institutional shareholders are likely to focus on the overall profitability of the companies whose shares they hold. A regulatory framework that relies on ongoing regulation by these well-established market players, rather than on mandatory rules and judicial oversight, is likely to exhibit precisely the qualities we have seen in this part: speed, certainty and an emphasis on promoting the interests of shareholders.

B. WILL THE UNITED KINGDOM'S TAKEOVER CODE ENDURE?

As we have seen, the geographic and social homogeneity of the City of London played an important role in both the formation of the Takeover Code and the enforcement of the Takeover Panel's rulings. However, there has in recent years been a dramatic growth in overseas ownership of U.K. shares, as Figure 2 illustrates.[279] Much of this can be attributed to hedge fund activity, largely U.S.-driven.[280] Overseas investors are likely to be less willing to follow local norms, raising the prospect of difficulties enforcing the Code.[281] However, a traditional strength of the Panel's enforcement technique has been its ability to impose sanctions on gatekeepers. The cooperation of trade associations meant that no professionals working in London's financial markets would be willing to advise a defaulting party.

Moreover, the Panel's enforcement powers have recently been strengthened as a result of the U.K. implementation of the European Union's Takeover Directive.[282] The Directive, which was held up for many years by disputes over the treatment of employees,[283] takes as its starting point many aspects of the British model of takeover regulation, both as to substance (the board neutrality rule and the mandatory bid rule) and as to procedure (oversight of takeovers to

278. For an exploration of institutional shareholder conflicts of interest, see Jill E. Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO ST. L.J. 1009, 1019–20, 1039–46 (1994); Rock, *supra* note 192, at 469–72. The other participants in the Takeover Code process also have imperfect incentives. The London Stock Exchange, for instance, has the same incentive to chill takeovers as just described with the New York Stock Exchange.

279. *See supra* text accompanying note 195.

280. *See, e.g.*, COMM'N OF THE EUROPEAN CMTYS., ALTERNATIVE INV. EXPERT GROUP, REPORT OF THE ALTERNATIVE INVESTMENT EXPERT GROUP: MANAGING, SERVICING AND MARKETING HEDGE FUNDS IN EUROPE 13 (2006), *available at* http://ec.europa.eu/internal_market/securities/docs/ucits/reports/hedgefunds_en.pdf (detailing U.S. contribution to world hedge fund industry).

281. To be sure, there have been various instances in the Panel's history where individuals overseas have disobeyed its rulings with seeming impunity. One example was the Panel's ruling in 1980 that James Raper and his associates should make a mandatory bid for St. Piran. *See* Michael Prest, *Takeover Panel Rules on St. Piran*, TIMES (London), Apr. 2, 1980, at 19. Raper, based in Hong Kong, was able to flout the Panel's ruling. S*ee* Michael Prest, *The Strange Affair of St. Piran*, TIMES (London), Apr. 29, 1981, at 23.

282. European Parliament and Council Directive 2004/25, 2004 O.J. (L142) 12 (EC).

283. The first proposal for a directive on takeovers was made by the European Commission as long ago as 1989. *See* COMM'N OF THE EUROPEAN CMTYS., HIGH LEVEL GROUP OF COMPANY LAW EXPERTS, REPORT OF THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS ON ISSUES RELATED TO TAKEOVER BIDS 13-17 (Jan. 10, 2002) (prepared by Jaap Winter et al.), *available at* http://ssrn.com/abstract=315322 [hereinafter *Winter Report*].

be through a regulator rather than courts).[284] It also contains a provision—the so-called "breakthrough rule"—designed to neutralize certain embedded defenses based on differential voting rights.[285] However, the board neutrality and breakthrough rules proved so controversial that the Directive was only passed by making these rules optional.[286]

The Directive adopts a model of regulatory (rather than judicial) oversight through a "supervisory authority." Whilst full-blown self-regulation was politically unacceptable in most Member States, the United Kingdom was able to negotiate for a text that permitted the Panel to be recognized as a supervisory authority through the expedient of domestic legislation empowering the Panel to act as such.[287] This has required the Code, for the first time in its history, to be put on a statutory footing.[288] However, this has been done with only minimal changes to how the Panel is constituted and how it goes about writing and applying the Code.[289] In form, the Code is therefore now statutory, but the substance of its self-regulatory approach has been preserved. Indeed, it is anticipated by the U.K. government, the Panel, and many commentators that little will change in the Panel's practice as a result of the Directive.[290]

Alongside the Panel's change in legal status have come new powers to

284. *See* Directive 2004/25, *supra* note 282, arts. 4 (supervisory authorities), 5 (mandatory bid), and 9 (obligations of the board of the offeree company).

285. *Id.* art. 11. The breakthrough rule neutralizes (subject to the payment of "equitable compensation") provisions in the target company's constitution and in contractual agreements between shareholders that provide for voting arrangements other than one-share, one-vote in the following circumstances: (i) after a bid has been announced in decisions about the use of defensive tactics which the board is bound to refer to shareholders, *id.* art. 11.3; and (ii) after a bidder has acquired 75% or more of the capital carrying voting rights, as regards the appointment or removal of board members or amendment of the constitution, *id.* art. 11.4. *See generally* Blanaid Clarke, *Articles 9 and 11 of the Takeover Directive (2004/25) and the Market for Corporate Control*, J. BUS. L. 355, 365–72 (2006).

286. *See* Directive 2004/25, *supra* note 282, art. 12. Member States implementing the Directive have the choice either to enact the board neutrality and breakthrough principles as mandatory rules *or* as opt-in defaults.

287. *Id.* art 4.1 ("[A]uthorities . . . shall be either public authorities, associations or private bodies recognised by national law. . . .").

288. *See* The Takeovers Directive (Interim Implementation) Regulations 2006, 2006 S.I. 2006/1183 (Eng.), *available at* www.opsi.gov.uk/SI/si2006/20061183.htm (transitional provisions, in force from May 20, 2006); Companies Act, 2006, c. 46, §§ 942–65 (Eng.) (in force from April 6, 2007). Under these, the Panel's Code Committee is empowered to write the Code, and its Hearing Committee to give binding rulings on its application.

289. One change has been the inauguration of a new Takeover Appeal Board to hear appeals from decisions of the Panel. *See* THE PANEL ON TAKEOVERS AND MERGERS, THE IMPLEMENTATION OF THE TAKEOVERS DIRECTIVE: PROPOSALS RELATING TO AMENDMENTS TO BE MADE TO THE TAKEOVER CODE 22–24 (2005) (U.K.), http://www.thetakeoverpanel.org.uk/new/consultation/DATA//PCP%20200505.pdf [hereinafter TAKEOVER PANEL, IMPLEMENTATION]; *see also* The Takeover Appeal Board, http://www.thetakeoverappealboard.org.uk/ (last visited May 16, 2007).

290. *See* Baker & Sagayam, *supra* note 63, at 386–89; *see also* DEP'T OF TRADE & INDUST., COMPANY LAW IMPLEMENTATION OF THE EUROPEAN DIRECTIVE ON TAKEOVER BIDS: A CONSULTATIVE DOCUMENT 11–17 (2005) (U.K.), http://www.dti.gov.uk/files/file10384.pdf; TAKEOVER PANEL, IMPLEMENTATION, *supra* note 289, at 2–3; Geoffrey Morse, *Implementing the Thirteenth EC Directive—The End of Self-Regulation in Form Only*, J. BUS. L., May 2005, at 403.

request court enforcement of its rulings.[291] It might be thought that such juridification will bring with it the possibility of tactical litigation in U.K. takeover disputes. Foreign investors in particular, unschooled in the United Kingdom's tradition of self-regulation, might be keen to raise a legal challenge if given the opportunity. However, at the U.K.'s insistence, Article 4(6) of the Directive provides that it does not affect any power of Member State courts "to decline to hear legal proceedings and to decide whether or not such proceedings affect the outcome of a bid" and Member States' power "to determine the legal position concerning the liability of supervisory authorities or concerning litigation between the parties to a bid."[292] The United Kingdom has relied on this provision in its implementation of the Directive. To counter the possibility that the Code's new legal basis might engender civil suits based on breach of its provisions, the new U.K. legislation expressly provides that contravention of the Code shall not have any consequence for the validity of transactions, nor give rise to any civil action against the wrongdoer.[293] Moreover, the Panel is exempted from any legal liability save for acts committed in bad faith, or which contravene the United Kingdom's Human Rights Act of 1998.[294] Thus the Panel's current mode of regulating seems secure for the foreseeable future.

At the same time, other developments in European company law raise the possibility that a certain degree of regulatory competition may emerge within the European Union.[295] The Takeover Directive prescribes that national takeover regulators will have jurisdiction to govern disputes relating to targets that are registered and listed in their jurisdiction, even if their main place of business is in another Member State.[296] When coupled with other recent European law developments that open the door for established companies to change their registered offices,[297] this raises the possibility that takeover regulation in Europe may, as it has been in the United States for many years, become subject to

291. *See* S.I. 2006/1183, *supra* note 288, reg. 11; *see also* Companies Act, 2006, c. 46, § 955 (Eng.).

292. *See* Directive 2004/25, *supra* note 282, art. 4(6).

293. *See* S.I. 2006/1183, *supra* note 288, reg. 12; *see also* Companies Act, 2006, c. 46, § 956 (Eng.).

294. *See* S.I. 2006/1183, *supra* note 288, reg. 16; *see also* Companies Act 2006, c. 46, § 961 (Eng.). While the Panel's decisions will still remain subject to the possibility of judicial review, the principle of no retrospective effect articulated in *Datafin* would appear to be protected by Article 4(6) of the Directive.

295. *See generally* sources cited *supra* note 7.

296. *See* Directive 2004/25, *supra* note 282, art. 4.2(a). A company may opt into aspects of a Member State's takeover regime concerning the conduct of a bid simply by listing in that jurisdiction. *Id.* art. 4.2(b). However, matters relating to the treatment of employees, the determination of "control" and the use of defensive tactics are left to the jurisdiction of the company's registered office. *Id.* art 4.2(e).

297. The most significant of these developments to date for established companies is the Cross-Border Mergers Directive. European Parliament and Council Directive 2005/56, 2005 O.J. (L310) (EC) 1. A recent European Court of Justice ruling has established that the Member State in which a merged entity has its registered office must recognize the company as operating there, even if its principal place of business is elsewhere. *See* Case C-411/03, SEVIC Systems AG, [2006] All E.R. (EC) 363 (Eng.).

regulatory competition.[298] If, as we have argued, the U.K. system of takeover regulation is generally desirable in the context of a corporate governance regime where stock ownership is dispersed, and the difference from the United States' regime results from the federal preemption of self-regulation, rather than pathologies of regulatory competition, then European shareholders—and the United Kingdom's Panel—should have nothing to fear from this. Our prediction would be that continental European firms undergoing a transition from blockholder to dispersed share ownership—a re-listing, for example, following a private equity exit—would find the United Kingdom's takeover regime a relatively attractive one.[299]

C. WILL GROWING INVESTOR ACTIVISM IMPACT U.S. TAKEOVER REGULATION?

If the influx of foreign investment, the Takeover Directive, and the possibility of regulatory competition are the major new developments on the U.K. horizon, the key variable in the United States is the recent emergence of institutional shareholders as a major factor in U.S. corporate governance. Two developments have taken center stage: namely, the sheer size of institutional shareholdings and the even more recent corporate activism of hedge funds.

During the 1950s and 1960s, the era of the first hostile takeovers, institutional share ownership was puny by U.K. standards. As reflected in Figure 1,[300] institutions held barely ten percent of U.S. equity in 1960 and well under twenty percent in the early 1970s, whereas U.K. institutional shareholdings were roughly twice as high. As of 2004, however, the picture looks quite different. U.S. institutions now hold fully half of all shares, having even eclipsed the ownership levels of their U.K. peers.[301] Might institutions begin to reshape American takeover regulation in their image?

In the early 1990s, when they first discovered institutional shareholders, some corporate law scholars were at least cautiously optimistic that these shareholders could revolutionize American corporate governance, ending the long tradition of shareholder passivity.[302] It quickly became apparent that conflicts of interest and free riding problems would prevent institutional shareholders from becoming nearly as great a force as their shareholding stakes might imply.[303] Yet pension funds, mutual funds and other institutional shareholders are now a

298. *See* Gérard Hertig & Joseph A. McCahery, *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?*, *in* AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE US, 545, 546–47 (John Armour & Joseph A. McCahery eds., 2006).

299. *See* Armour, *supra* note 7, at 515–16.

300. *See supra* p. 1768.

301. U.K. institutions now hold slightly less than fifty percent of U.K. shares. *See* Figure 2, *supra* p. 1769.

302. *See, e.g.*, Black, *supra* note 192, at 831–39; Bernard S. Black, *Next Steps in Proxy Reform*, 18 J. CORP. L. 1, 52–54 (1992); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 566–75, 608 (1990).

303. *See, e.g.*, Fisch, *supra* note 278, at 1025–34; Rock, *supra* note 192, at 453–64.

much more important force in U.S. corporate governance than in the past. The institutions themselves trace their greater involvement to early 1988, when the Department of Labor sent a letter to Avon suggesting that pension fund managers have an obligation to act as informed fiduciaries when they vote on corporate issues.[304] Within a few weeks, the client list of Institutional Shareholder Services (ISS), which shareholder activist Robert Monks had founded several months earlier to provide advisory services, mushroomed as institutional shareholders sought advice on voting and other issues. Two decades later, Institutional Shareholder Services has become a significant enough presence in U.S. corporate governance that a critic recently complained that a new SEC rule requiring institutions to disclose their votes has "shift[ed] control over U.S. public companies from their boards to [ISS]."[305]

Our analysis of U.K. institutions' activism on rules issues, as contrasted with company-specific activism, suggests that it is at least possible that U.S. institutional shareholders will press for takeover reform in the coming years. Although U.S. institutions are still more far-flung than their U.K. counterparts, ISS serves as a focal point for coordination, and institutions as a group would benefit from more shareholder-oriented takeover regulation. Recent ISS support for increased shareholder democracy in directorial elections could be seen as the precursor to more active involvement in takeover regulation.

Despite their new clout, however, we doubt that the institutions represented by ISS will make a serious dent in existing takeover regulation, much less privatize the process as their U.K. counterparts did in the 1960s. First, as we have seen, the option of privatization has been foreclosed ever since the New Deal's securities acts. We suspect that the traditional American suspicion of financial institution influence would quickly rear its head if institutional shareholders attempted to re-engineer U.S. corporate governance and to assert direct control over takeover regulation.

Secondly, the existing mode of regulation—judge-made law—imposes greater coordination costs on groups seeking to change the rules than would more centralized regulation. Because investor engagement is focused on lawsuits, which relate to particular sets of facts, U.S. institutions seeking to coordinate must do so in the shadow of the immediate costs and benefits of litigation. Against this background, the collective benefits to the institutions as a group, of changing the law through establishing a precedent will seem less salient. The evidence to date suggests that the costs of coordinating on litigation are considerable.[306]

304. Labor Dep't Letter on Proxy Voting By Plan Fiduciaries, 15 BRP 391 (Feb. 29, 1988).

305. Lynn A. Stout, *Why Should ISS Be The New Master of the Corporate Governance Universe?*, CORP. GOV., Jan. 4, 2006, at 14, 14. ISS currently has a total of 1667 clients. *See* Institutional Shareholder Services, *About ISS*, *available at* http://www.issproxy.com/about/index.jsp (last visited Mar. 14, 2007).

306. In a recent empirical study on securities fraud class actions, Cox and Thomas find that while the presence of an institutional investor as lead plaintiff is statistically associated with a higher settlement

Thirdly, although it would in theory be open for the institutions to lobby for SEC oversight of takeover defenses, Delaware's accommodation of its judicial process to the exigencies of the takeover era has reduced the gains to be expected from an alternative regulatory regime. Delaware also could be expected to fight any movement to dislodge its courts from their central role in takeover regulation. Moreover, although the other forty-nine states are also-rans in the competition to attract corporate charters, many would resist any movement that challenged the antitakeover laws they have put in place to discourage takeovers of companies incorporated in the state.

In short, the institutional shareholders that are represented by ISS may nibble at the edges of American corporate governance, but they are unlikely to privatize or even force a restructuring of U.S. takeover regulation.

A very different kind of institution, hedge funds, has taken a more aggressive stance in U.S. corporate governance, and has a rather different set of institutional incentives. Hedge fund (and to a lesser extent, equity fund) activism has been the most dramatic new development in American corporate governance. High profile skirmishes between hedge funds and the management of Time-Warner, General Motors and other corporations have served warning that hedge funds are not likely to sit idly by when they invest in publicly held companies. Will hedge funds re-shape the contours of U.S. takeover regulation?

As with the more traditional institutions, we doubt that hedge funds will alter the regulatory landscape, but for almost precisely the opposite reason. Rather than holding a broad portfolio of stocks, the hedge funds that have ventured into corporate governance make large, targeted investments in a small number of companies. This gives them a powerful incentive to engage in single company activism, but much less of an incentive to focus on improving the overall rules of the game.[307] As a result, even if the new hedge fund activism shakes up U.S. corporate governance generally, it is unlikely to dramatically alter U.S. takeover regulation.

We do not mean to suggest that traditional institutional shareholders and hedge funds will have no effect on the U.S. takeover markets at all. But the

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rate, *see* Randall S. Thomas and James D. Cox, *An Empirical Analysis of Institutional Investors' Impact as Lead Plaintiffs in Securities Fraud Class Actions* 64 (Vanderbilt Law & Econ., Research Paper No. 06-09, 2006), *available at* http://ssrn.com/abstract=898640, only approximately 30% of institutional investors with provable losses bother to perfect their claims in class action settlements. *See* James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 424 (2005).

307. This is especially true given that, unlike traditional institutional shareholders, hedge funds are not forced to keep most or all of their investments in the equity and debt markets. Hedge funds can invest in almost anything they wish, which means that they simply exit the equity markets as an alternative to attempting to improve the rules of the game.

The one issue on which hedge funds and equity funds do lobby actively is regulation of the funds themselves. For a discussion of equity funds' recent efforts "to pre-empt the types of moves toward federal regulation that have emerged for their hedge-fund cousins," see Brody Mullins & Kara Scannell, *Buyout Firms Join Lobbying Efforts*, WALL ST. J., Sept. 1, 2006, at A4.

court-centered U.S. approach seems likely to endure even as international financial markets are transformed by the rise of hedge funds and advent of sophisticated new forms of financial intermediation.

CONCLUSION

In both the English and American systems of corporate governance, each of which feature dispersed share ownership, the hostile takeover is thought to operate as a disciplinary mechanism for management. Yet both the content of the rules governing the resolution of takeover battles and the way in which they are made and enforced are quite different in the two systems. Our analysis has explored the causes of this divergence and its implications for policymakers.

Critics of the U.S. system have compared it unfavorably to the U.K.'s takeover regulation, and accounted for the difference as flowing from the dynamics of competitive federalism. Our public choice account, in contrast, places the mode of regulation at center-stage in explaining how the differences emerged. Public choice theory implies that legal rules will come to favor the interests of the group(s) with the greatest influence over the rule-making process. In a system of self-regulation, those groups which have the greatest interest in the regulated activity are likely to organize themselves so as to control the rule-making agenda. This fits squarely with the fact that British institutional investors, who for many years have owned the majority of the shares in U.K. quoted companies, are the group whose interests have shaped the Takeover Code.

Regardless of how well informed they are about policy issues, judges can only decide cases which come before them. Thus, in a system where the law is judge-made, the crucial issue is which group is able to exert the greatest influence over the decision to take cases to trial. The structure of bidder and shareholder litigation to enforce directors' duties—for example, in a hostile takeover bid situation—tends to be biased towards the interests of directors, leading the content of precedents to be more favorable to their interests. Our claim that the difference in substance flows from the mode of regulation, as opposed to the existence of regulatory competition in the United States, is reinforced by the fact that the *common law* of directors' duties in the United Kingdom, which is not a federal system, is much closer to the substance of the U.S. model than it is to the Takeover Code.

The question posed by this analysis is why the U.K. institutional investors were able to "privatize" their takeover regime through self-regulation, whereas their counterparts in the United States were not. The answer to this, we consider, lies in the decades old legislation that fragmented U.S. financial institutions and vested authority over the markets in the SEC. Congress not only made it more difficult for institutional investors to coordinate, but it directly preempted certain types of self-regulation by stock exchanges. Had it not been for these legal features of the U.S. landscape, we think it likely that institutional investors would have been able to coordinate similarly to their U.K. counterparts so as to obviate the need for litigation. Given that both the process and substance of the U.K.'s self-regulatory regime are selected and developed by those who have most at stake in the process, there are strong prima facie reasons for thinking it may be superior to that which has prevailed in the United States.

The implications of this for U.S. policymakers are twofold. On the one hand, the costs of the federal legislation which restricted institutional investor interaction may be significantly more than have been appreciated. At the same time, there is a certain irony in the fact that prominent critics of U.S. takeover law suggest that the solution is to introduce federal legislation along the lines of the U.K.'s Takeover Code. In our view, federal regulation is the explanation for the managerialist U.S. approach, not the solution.

Our rejection of the "orthodox" explanation for the more manager-friendly U.S. takeover rules, which is based on alleged pathologies of regulatory competition, also has important implications for the growing possibilities for regulatory competition within the European Union. Our account, in contrast, does not imply that the United Kingdom's takeover regime is likely to be weakened by developing regulatory competition. If anything, we expect its cost advantages to attract, rather than deter, reincorporations.

Finally, the contrast between the U.S. and U.K. approaches has considerable relevance for emerging economies both in Europe and elsewhere in the world. Reformers have too often assumed that the top-down, mandatory regulation, together with courts, is the only way to regulate corporate transactions in emerging economies. But the success of the United Kingdom's Takeover Panel suggests that this assumption is seriously flawed. The U.S. approach requires an effective governmental regulator, together with an efficient court system. In many emerging economies, one or both of these elements is missing. In some, the parties that are most directly affected by corporate regulation—large shareholders, banks and exchanges—are located in close proximity to one another. And they have a direct financial stake in the success of the regulatory framework. In this context, informal self-regulation might prove more effective than the U.S. combination of formal statutes and courts. The U.K. strategy will not invariably be the best, any more than the approach in the United States. But reformers and lawmakers should keep in mind that there at least two ways to regulate takeovers, not just one.