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# The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets

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# The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework

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John Armour  
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## The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework

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*In each of the three largest economies with dispersed ownership of public companies—the United States, the United Kingdom, and Japan—hostile takeovers emerged under a common set of circumstances. Yet the national regulatory responses to these new market developments diverged substantially. In the United States, the Delaware judiciary became the principal source and enforcer of rules on hostile takeovers. These rules give substantial discretion to target company boards in responding to unsolicited bids. In the United Kingdom, by contrast, a private body consisting of market professionals was formed to adopt and enforce the rules on hostile bids and defenses. In contrast to those of the United States, the U.K. rules give the shareholders primary decisionmaking authority in responding to hostile takeover attempts. The hostile takeover regime in Japan, which developed recently and is still evolving, combines substantive rules with elements drawn from both the United States (Delaware) and the United Kingdom, while adding distinctive elements, including an independent enforcement role for Japan's stock exchange.*

*This Article provides an analytical framework for business law development to explain the diversity in hostile takeover regimes in these three countries. The framework identifies a range of supply and demand dynamics that drives the evolution of business law in response to new market developments. It emphasizes the common role of subordinate lawmakers in filling the vacuum left by legislative inaction, and it highlights the prevalence of “preemptive lawmaking” to avoid legislation that may be contrary to the interests of important corporate governance players.*

*Extrapolating from the analysis of developed economies, the framework also illuminates the current state and plausible future trajectory of hostile takeover regulation in the important emerging markets of China, India, and Brazil. A noteworthy pattern that the analysis reveals is the ostensible adoption—and adaptation—of “best practices” for hostile takeover regulation derived from Delaware and the United Kingdom in ways that protect important interests within each emerging market's national corporate governance system.*

### INTRODUCTION

Internationally, hostile takeovers are a rare phenomenon, occurring with any frequency in only a handful of countries.<sup>1</sup> They are rare because they can only take place in companies with dispersed stock ownership, themselves

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1. See PEPPER D. CULPEPPER, *QUIET POLITICS AND BUSINESS POWER: CORPORATE CONTROL IN EUROPE AND JAPAN* 33, Table 2.3 (2011) (showing median of two completed hostile takeovers and six

something of a rarity internationally.<sup>2</sup> Where the ownership of a country's publicly traded firms becomes diffusely held, at some point hostile takeover activity is likely to develop. This sequence of events has been followed in each of the three large economies in which ownership of public corporations is arguably the most diffuse, most recently in Japan, and decades before—during the post-war period—in the United States and the United Kingdom.<sup>3</sup> In each case, the first such takeovers were highly controversial, being a new departure for much of the business community and workforce. Moreover, the existing regulatory framework typically was inadequate to address the legal issues that these new challenges for corporate control raise. The advent of hostile takeovers was, therefore, a stimulus for the development of new regulatory regimes.

In this Article we examine the way this regulation took shape. Our goal is to understand how the earlier experience of the United States and the United Kingdom can inform our understanding of recent events in Japan, and whether further extrapolation may illuminate regulatory regimes in other significant markets where ownership structures may be changing—particularly in the emerging economies of China, India, and Brazil. We believe the underlying evolutionary dynamics that drove the development of hostile takeover regimes in highly developed capital markets are likely to be played out eventually in the emerging markets as well. Thus, there is a potentially high payoff from considering the evolution of takeover regimes in developed and emerging markets. In brief, for the developed economies we show that the legislature was absent from the process in all three countries, and that subordinate lawmakers therefore developed the rules for hostile takeovers. But the identity of the subordinate lawmakers who took the initiative differed substantially across the three countries. We attribute this diversity to national differences in the role that courts play in resolving business disputes, and to the strength of key interest groups such as institutional investors. The identity of the subordinate lawmaker, in turn, has major consequences for both the substance and enforcement of the regulations.

Understanding the varied development of legal regimes for hostile takeovers is important on several levels. First, how countries regulate these transactions has potentially profound consequences for managerial behavior, investor returns, and the allocation of assets within the economy. Second, over the past decade, much academic debate has focused on whether globalization is causing national systems of corporate law and governance to con-

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attempted hostile takeovers in nineteen countries from 1990–2007, as compared to a median of 321 completed friendly mergers).

2. See, e.g., Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471, 471 (1999).

3. See *id.* at 491, 493; cf. Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1395 (2009) (finding that ninety-six percent of US public firms have blockholders who own an average of thirty-nine percent of these firms' common stock).

verge.<sup>4</sup> As more fully discussed below, however, rather than global convergence, there is a striking degree of *divergence* in the way hostile takeovers are regulated in highly developed economies with sophisticated capital markets. Perhaps unsurprisingly, given this diversity, there are few signs that emerging markets are converging around a global set of “best practices” in their approach to hostile takeovers.

In Part I of this Article, we sketch an overview of the dynamics that we suggest determine how business law evolves in response to significant new market developments. As an important example of such a development, hostile takeovers provide a good case study for exploring these dynamics.

In Part II, we trace the development of hostile takeovers and institutional responses to them in the United Kingdom, the United States, and Japan. This exercise reveals a common pattern of factors that lead to the emergence of hostile bids in the three countries. In each case, the regulatory framework underwent development in response to this new phenomenon. However, the way in which this happened differed greatly across the three countries, in terms of both the substantive rules and the institutions responsible for their production and enforcement.

Part III seeks to explain these differences using the analytical framework developed earlier in the Article. The subordinate lawmakers who filled the vacuum created by legislative inaction differed across the three countries due to different judicial traditions and markedly different levels of institutional investor influence, leading to vast divergence in the substantive rules and enforcement institutions. Japan’s unique hybrid approach is likely a function of its late stage of institutional development for hostile takeovers relative to the United States and the United Kingdom. Thus, its experience may provide particularly salient lessons for emerging markets.

Finally, Part IV extends the analysis to three major developing markets—China, India, and Brazil—which have yet to experience significant hostile takeover activity. Our analytical framework, particularly when applied in light of the historical experiences of the United Kingdom, the United States, and Japan, helps explain the existing pattern of takeover regulation in these emerging markets, and offers an intellectual roadmap for understanding their possible future institutional trajectories.

## I. ANALYTIC FRAMEWORK

The advent of hostile takeovers in a given country is a particularly significant market development, but one that nevertheless can be explained using the same analytical tools used to understand many other aspects of business law. We first discuss ways in which demand for business law reform by

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4. For a compilation of diverse perspectives, see *CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE* (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

interest groups and the public at large is channeled, and second the institutions responsible for supplying new legal rules. The interaction of demand- and supply-side factors accounts for the way in which new business regulation emerges.

#### A. Channels of demand for business law reform

Demand for law reform following a change in business practice can be channeled in at least three distinct ways. One is for the specific persons—*individuals and firms*—that the practice affects to take action. If we were to imagine a timeline of the emergence of a new practice, it is plausible that demand for law reform would arise from such persons first, before the other channels discussed below could become operative. Because markets consist of transactions between persons, those involved in them will inevitably first feel the arrival of a new market practice. Those among them who the practice adversely affects may seek some form of legal protection for their interests. However, the resources they will rationally devote to obtain such protection will be limited to the size of the specific personal interests they have at stake.

A second channel is *interest group lobbying*. In terms of our timeline, we can posit that this probably will not occur until a practice becomes more widely understood and significant numbers of persons become aware that they have a shared interest at stake. Interest groups pool individual resources to lobby for law reform—that is, to do whatever is permissible to influence lawmakers.<sup>5</sup> The pooling of resources means that the extent and range of forms that such influence may take are much greater than specific persons acting alone would be able to achieve.

In business law, investors, managers, and employees have clear stakes in the issues; their respective ability to organize and input their views into the lawmaking process may be expected to significantly affect the content of business laws.<sup>6</sup> However, the extent to which the actions of such groups are successful will, of course, depend on many other aspects of a nation's political and legal environment. Other parts of the legal framework and social institutions may, in turn, affect the relative abilities of the groups to affect business laws.<sup>7</sup> For example, the ability of managers to use corporate assets to fund lobbying will greatly enhance their influence.<sup>8</sup> Similarly, in coun-

5. See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 6–7 (1965).

6. See, e.g., MARK J. ROE, *POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE* 5 (2003).

7. See generally Lucian A. Bebchuk & Zvika Neeman, *Investor Protection and Interest Group Politics*, 23 *REV. FIN. STUD.* 1089 (2010) (identifying the effect that lobbying by entrepreneurs of private companies, insiders, and institutional investors has on the protection of investors); Marco Pagano & Paolo F. Volpin, *The Political Economy of Corporate Governance*, 95 *AM. ECON. REV.* 1005 (2005) (finding that proportional election systems protect investors less and protect employees more than majoritarian election systems).

8. See generally Wendy L. Hansen & Neil J. Mitchell, *Disaggregating and Explaining Corporate Political Activity: Domestic and Foreign Corporations in National Politics*, 94 *AM. POL. SCI. REV.* 891 (2000).

tries with large, well-funded labor unions, employee lobbying is likely to be more pronounced than in countries where the activities of unions are curtailed.<sup>9</sup> Moreover, the provision of finance through institutional investors, as opposed to direct retail investments, will produce investor groups that are better organized and more sophisticated in their inputs into the lawmaking process.<sup>10</sup>

Episodically, a third channel may operate. From time to time, specific business issues acquire widespread political salience,<sup>11</sup> leading to a *populist* demand for reform. Such demands have occurred, more often than not, in response to a business-related scandal, such as the Enron and WorldCom scandals in the United States, or a controversial event such as a foreign bidder acquiring a well-known domestic corporation.<sup>12</sup> In these circumstances, a more populist agenda trumps the “ordinary” channels through which demand for business law reform flows. The resulting direction of reform is likely to be contrary to the perceived interests of the constituencies dominating the other channels, and is also likely to be crafted quite specifically to respond to the perceived scandal. For example, the New Deal reforms of the 1930s responded directly to the perceived failings of 1920s securities markets, and were intended to rein in the activities of the Wall Street finance elite who had previously dominated those markets.<sup>13</sup> Similarly, the Sarbanes-Oxley Act of 2002 responded very specifically to the problems evidenced at Enron, and imposed considerable new costs on corporate managers, the constituency whose power was thereby curtailed.<sup>14</sup> The recent Dodd-Frank legislation also follows this pattern, responding specifically to the per-

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9. See PETER A. GOUREVITCH & JAMES J. SHINN, *POLITICAL POWER AND CORPORATE CONTROL: THE NEW GLOBAL POLITICS OF CORPORATE GOVERNANCE* 284 (2005).

10. See John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1767–76 (2007).

11. A policy issue is politically “salient” if it causes the media, and (as a consequence) the voting public, to focus attention on it. Where an issue achieves high political salience, the likelihood increases that elected officials will focus on it, and, given enough political pressure, seek to regulate it. Where an issue has low political salience, the reverse is true.

12. See, e.g., CURTIS J. MILHAUPT & KATHARINA PISTOR, *LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD* (2008) (discussing political responses to corporate scandals in the United States, Germany, Japan, South Korea, China, Singapore, and Russia); MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* 152–53 (1994) (discussing voters’ hostility to hostile takeovers in the 1980s); DAVID A. SKEEL, JR., *ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM* 144–74 (2005) (discussing the failure of shareholders to monitor Enron and WorldCom).

13. See ROE, *supra* note 12, at 94–96 (discussing Congress’s motives in passing the Banking Act of 1933 and the Glass-Steagall Act); see also JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 1–212 (3d ed. 2003) (narrating the history of the U.S. Securities and Exchange Commission (“SEC”) from its creation in 1934 through the end of the 1930s).

14. See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1591–94 (2005).



ceived failings of financial markets and institutions in the run up to the recent subprime lending fiasco and global financial crisis.<sup>15</sup>

*B. Institutional responsiveness in supply of business law reform*

Any analysis of the institutional and regulatory response to hostile takeovers must also take into account the possible ways in which changes in the law may be *supplied*. Here, we discuss four: primary legislation, judicial decisions, regulation by government agencies, and private agreement among market actors.

While primary *legislation* may seem the most obvious way in which new business law would be supplied, the complexity of modern business activity and the competitive pressures for legislative attention in modern democracies suggest that legislative intervention is likely to be costly compared with other channels. In democratic societies, politicians may be expected to act so as to maximize their chances of (re-)election.<sup>16</sup> With majoritarian voting rules, election outcomes are typically decided by the voting behavior of individuals whose preferences lie somewhere in between the policies espoused by major parties—in other words, the “median” voter in policy preference terms.<sup>17</sup> Politicians may therefore be expected to focus their legislative energies on matters likely to be of interest to the median voter. Because legislation takes time and effort to produce (or be prevented), only a finite amount can be achieved in any given session. It follows from the foregoing that legislators will focus their energies on the matters likely to be of *greatest* significance—real or perceived—to the median voter. As the details of business practices are complex, and usually not well-understood by the population at large, they are unlikely to be particularly salient for such voters in most cases.<sup>18</sup> Consequently, legislators may be expected to de-prioritize such matters in their agenda. It is a plausible conjecture that much of the relevant work may therefore be delegated to what may loosely be termed “subordinate lawmakers.”<sup>19</sup>

15. See generally Wall Street Reform and Consumer Protection Act of 2010, H.R. 4173, 111th Cong. (2010).

16. See generally JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT* (1962) (arguing that politicians' behavior can best be understood by applying economic models of utility maximization); ANTHONY DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* (1957) (arguing that economic theories of rationality and utility maximization can be used to analyze and understand politicians' behavior).

17. For a classical statement of this model, see James L. Barr & Otto A. Davis, *An Elementary Political and Economic Theory of the Expenditures of Local Governments*, 33 *SO. ECON. J.* 149, 154 (1966). For a more recent review, see Roger D. Congleton, *The Median Voter Model*, in *THE ENCYCLOPEDIA OF PUBLIC CHOICE* 382, 384 (Charles K. Rowley & Friedrich Schneider eds., 2003).

18. CULPEPPER, *supra* note 1, at 1–8.

19. It is assumed for the purposes of this discussion that any contemplated business law rules are consistent with governing constitutional ordinances, with the consequence that all other potential lawmakers—including the judiciary—are hence “subordinate” to the legislature.

In this Article, we consider threshold conditions under which three non-legislative institutions—the judiciary, public regulators, and market actors—might step up to provide reforms as subordinate lawmakers.

While traditional legal theory in both common law and civil law systems denied the existence of “judicial legislation,” the role of judges as lawmakers—whether through deciding cases on new issues, overruling existing precedents, or even deciding how best to distinguish a precedent—is a fact of life.<sup>20</sup> Such lawmaking can be seen as taking place through the *judiciary*. Civil procedure imposes a powerful constraint on judicial lawmaking, however, as judges in most legal systems can decide only those questions that are brought before them in litigation. Procedural rules that promote broad standing or lower the costs of litigating an issue may be expected to lower the costs of judicial lawmaking and increase its use. So, too, may other variables that affect the quality of judicial institutions, including the selection and training of judges, the strength of the doctrine of precedent, degree of court specialization, and judicial independence.<sup>21</sup>

Another potential maker of business rules is a *public regulator*—that is, an agency to which legislative authority is explicitly delegated. Regulators are likely to have a technocratic advantage such that they can design and supply new rules at relatively low cost compared to the legislature, but they can only do so within the limits of their jurisdiction, which in turn depends on the circumstances under which the regulatory agency came into being. Subject to this constraint, agencies are likely to be favorably predisposed to generate new rules, since greater activity tends to justify their existence and increase their power, prestige and budgets.<sup>22</sup>

Finally, rules governing business conduct might be produced by *market actors*—participants in business enterprise themselves. At the most obvious level, many of the contractual or contract-like aspects of business law are produced in this way; good examples include the contents of master agreements for over-the-counter derivatives transactions,<sup>23</sup> provisions in “poison

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20. See generally *Re Spectrum Plus Ltd.* [2005] UKHL 41, [2005], [31]–[38] (appeal taken from EWCA Civ) (arguing that the common law in the United Kingdom is judge-made law); BENJAMIN CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 113–15 (1921) (discussing the processes and philosophy of judge-made law in the United States); SIR BASIL MARKESINIS, *COMPARATIVE LAW IN THE COURTROOM AND CLASSROOM* (2003) (arguing that judge-made law is a cornerstone of most civil law systems). On distinguishing precedents as a source of lawmaking, see generally Nicola Gennaioli & Andrei Shleifer, *The Evolution of Common Law*, 115 J. POL. ECON. 43 (2007).

21. Gillian K. Hadfield, *The Levers of Legal Design: Institutional Determinants of the Quality of Law*, 36 J. COMP. ECON. 43, 50–56 (2008); see also Simeon Djankov et al., *Courts*, 118 Q. J. ECON. 453, 510–11 (2003).

22. Cf. GORDON TULLOCK, *THE POLITICS OF BUREAUCRACY* 134–36 (1965) (discussing bureaucrats’ incentives to maximize the number of subordinates under their control). This propensity may intensify where the issue in question is potentially subject to the jurisdiction of more than one agency: the opportunity cost of failure to act may be increased by the possibility that the other agency may act first, thereby taking for itself any associated allocation of resources.

23. See, e.g., Dan Awrey, *The Dynamics of OTC Derivatives Regulation: Bridging the Public-Private Divide*, 11 EUR. BUS. ORG. L. REV. 155, 164 (2010).

pill” mechanisms used by U.S. companies,<sup>24</sup> and boilerplate terms in lending agreements.<sup>25</sup> Moreover, where groups of participants interact with one another on a repeated basis, norms promoting group welfare sometimes emerge and may be supported by reputational sanctions.<sup>26</sup> The feasibility of using reputational sanctions to enforce private rules will depend in the first instance on the nature of the community: there must be sufficiently valuable potential future interactions to make commercial ostracism a real threat.<sup>27</sup> Thus, effective norm-based private rules presuppose a high degree of homogeneity among participants who can agree on the nature of the rules as well as the definition and incidence of a breach. Norms so conceived, however, cannot always be readily updated in response to a change in circumstances, as they require a change in thinking by the community at large.<sup>28</sup> The responsiveness of private rules can be enhanced, however, by the establishment of a private body—such as a trade association or a merchant guild—tasked with updating these rules.<sup>29</sup> When that occurs, the analysis more closely resembles that used in the case of public regulators.

“Hybrid” institutions that overlap these categories may also emerge. For example, a stock exchange may begin life as a purely market-based rulemaker, relying on reputational sanctions alone. The exchange may subsequently be co-opted by the state, being granted the status of a public agency with the associated power to invoke legal enforcement of its rulings, but subject to constitutional limitations on its powers. Such agencies may even create specialist tribunals that issue judicial opinions. Hybrids are prevalent, and most real-world institutions can be effectively analyzed as a

24. See, e.g., John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CAL. L. REV. 1301, 1307 (2001); Michael J. Powell, *Professional Innovation: Corporate Lawyers and Private Lawmaking*, 18 L. & SOC. INQUIRY 423, 434–35 (1993).

25. See, e.g., Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting* (Or “The Economics of Boilerplate”), 83 VA. L. REV. 713, 718 (1997).

26. ROBERT C. ELLICKSON, *ORDER WITHOUT LAW* 139 (1991); see also John Armour & Simon Deakin, *Norms in Private Insolvency: The “London Approach” to the Resolution of Financial Distress*, 1 J. CORP. L. STUD. 21 (2001) (discussing how financial distress is resolved among creditors of large U.K. firms); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001) (discussing the development of a private commercial law system in the cotton industry); Avner Greif, *Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders*, 44 J. ECON. HIST. 857 (1989) (discussing the reputational mechanism used by eleventh-century Mediterranean 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) (discussing the development of a reputational mechanism on the Internet, in the form of digital certificates and digital seals).

27. See Bentley W. MacLeod, *Reputations, Relationships, and Contract Enforcement*, 54 J. ECON. LIT. 595, 608–15 (2007).

28. See Randal C. Picker, *Simple Games in a Complex World: A Generative Approach to the Adoption of Norms*, 64 U. CHI. L. REV. 1225 (1997) (discussing collective action problems in the adoption of social norms).

29. See, e.g., Armour & Skeel, *supra* note 10, at 1760–61 (U.K. Takeover Panel); Bernstein, *supra* note 26, at 1225 (cotton industry trade association). The American Law Institute’s production of Restatements of case law is an additional example. See Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595, 596 (1995).

combination of the elements described in our four ideal types of institution above.<sup>30</sup>

Before concluding this part of the discussion, we should note a general constraint on lawmaking by subordinate institutions: namely, the imperative to act consistently with the preferences of the legislature. The legislature can impose this imperative through a combination of ex ante structuring of jurisdiction and ex post monitoring.<sup>31</sup>

To summarize the discussion thus far: legal rules may originate with a variety of institutions, not just the legislature. The threshold conditions under which each of these institutions may be capable of supplying legal reforms vary. For business-related matters, the legislature is rarely likely to have sufficient interest or expertise; intervention by way of primary legislation may be expected only following a scandal or other event generating a high degree of public salience. Judicial lawmaking requires an amenable civil procedural regime that would enable cases to be brought cheaply and quickly after a change in business practice so as to allow precedents to be developed and updated promptly. A public regulator may act more swiftly, but can only do so within the scope of its jurisdiction. Finally, market actors may also act swiftly, but reputational sanctions are only effective when there exists a sufficient degree of repeated interaction among the members of the relevant community.

### C. *Interaction of supply and demand*

Having surveyed the channels through which demand for law reform may be mediated and the institutions which may supply such laws in response, we now consider how these phenomena interact. Various lawmaking institutions exhibit different degrees of responsiveness to the different channels of demand for law reform.

First, consider the role of individuals or firms acting alone to try to protect their interests where these are adversely affected by a development in business practice. Having limited resources, they will find it difficult acting alone to sway legislators, bureaucrats, or industry associations. However, if the new practice affects their private law rights, they may be able to mount a challenge in court, potentially resulting in a new precedent. Consequently, judicial lawmaking is likely to be the only channel through which persons acting individually may be able to change the law.

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30. Our case studies, discussed in Parts II and III, provide a number of examples of such overlap.

31. See, e.g., Kathleen Bawn, *Choosing Strategies to Control the Bureaucracy: Statutory Constraints, Oversight, and the Committee System*, 13 J. LAW, ECON. & ORG. 101 (1997) (discussing Congress's use of oversight and statute to exert control over administrative agencies); Randall L. Calvert et al., *A Theory of Political Control of Agency Discretion*, 33 AM. J. POL. SCI. 588 (1989) (discussing lawmakers' constitutional and electoral constraints); B. Dan Wood & Richard W. Waterman, *The Dynamics of Political Control of the Bureaucracy*, 85 AM. POL. SCI. REV. 801 (1991) (discussing the scope and mechanisms of political control of the bureaucracy).

Next, consider responsiveness to *lobbying* by interest groups. The judiciary is likely to be the least responsive institution to this channel of demand because the integrity of the judicial process depends crucially on the perceived impartiality of the judiciary.<sup>32</sup> Despite this fact, it is not necessarily true that the political views of judges never influence their decisions,<sup>33</sup> or that parties with greater financial resources are unable to improve their position before a judge by hiring a more skilled or articulate legal advocate.<sup>34</sup> However, standing rules, which typically permit only parties with an interest in a civil matter to initiate litigation, make it relatively difficult for interest groups to organize in order to bring about precedential change.<sup>35</sup> Such standing requirements limit the extent to which interested parties can proactively seek law reform from the judiciary. Standing rules also impede the formation of alliances of interest by creating free-rider problems for any party that does not have the standing and the resources to challenge a precedent.<sup>36</sup>

While it may generally be easier for interest groups to sway legislative outcomes than judicial outcomes, legislative responsiveness to interest group lobbying for law reform also depends on the complexity of the issues and the size of the legislative agenda.<sup>37</sup> This may encourage interest groups to focus on regulators and market actors, institutions that are more likely than the legislature to introduce new business rules.

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32. Cf. MARTIN SHAPIRO, COURTS (1981) (critiquing the conventional idea of the judiciary as an institution independent from outside influence).

33. On the influence of judicial political preferences, see, for example, Nicola Gennaioli & Andrei Shleifer, *Judicial Fact Discretion*, 37 J. LEG. STUD. 1 (2008) (judicial determination of questions of fact); Tracey E. George & Lee Epstein, *On the Nature of Supreme Court Decision Making*, 86 AM. POL. SCI. REV. 323 (1992) (voting by Supreme Court justices); Jordi Blanes i Vidal & Clare Leaver, *Pandering Judges* (Suntory & Toyota Int'l Ctrs. for Econ. & Related Disciplines at London Sch. of Econ. & Political Sci., Research Paper No. EOPP002, 2008), available at <http://ssrn.com/abstract=1546896> (judicial promotions).

34. See, e.g., Martin J. Bailey & Paul H. Rubin, *A Positive Theory of Legal Change*, 14 INT'L REV. L. & ECON. 467, 472–73 (1994) (discussing litigants' use of resources to establish favorable precedents); Gillian K. Hadfield, *Exploring Economic and Democratic Theories of Civil Litigation: Differences Between Individual and Organizational Litigants in the Disposition of Federal Civil Cases*, 57 STAN. L. REV. 1275, 1285 (2004) (noting the increasing disparity in resources between individual and organizational litigants); Keith N. Hylton, *Information, Litigation, and Common Law Evolution*, 8 AM. L. & ECON. REV. 33, 44–46 (2006) (discussing the interaction of the differential stakes model and informational asymmetries in civil litigation); Anthony Niblett et al., *The Evolution of a Legal Rule* (Nat'l Bureau of Econ. Research, Working Paper No. 13856, 2008) (surveying judicial application of the economic loss rule in the face of relative economic power differentials between plaintiffs and defendants), available at <http://www.nber.org/papers/w13856.pdf>.

35. In some jurisdictions, standing rules are relaxed so as to permit parties without a stake in the outcome to bring claims. A notable example is “public interest litigation” before the Indian Supreme Court. The Indian rule engenders large amounts of interest group-led litigation, reinforcing the significance of standing rules in avoiding such actions in most jurisdictions. See John Armour & Priya Lele, *Law, Finance, and Politics: The Case of India*, 43 LAW & SOC'Y REV. 491, 512–14 (2009).

36. To be sure, in some circumstances particular types of litigation may tend to favor particular constituencies. Most notably, repeat players and defendants in representative actions may face lower free-rider problems than their adversaries. See Marc Galanter, *Why the “Haves” Come out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95, 98–100 (1974).

37. See *supra* text accompanying notes 5–10, 16–18.

Finally, consider *populist* demands for law reform. For the same reasons that apply to lobbying by interest groups, these demands cannot readily be met through the judicial process.<sup>38</sup> For other subordinate lawmakers, however, the usual dynamics are reversed. By the very nature of the issue—one that has acquired populist significance—legislators can gain political capital, rather than lose it, by responding to these issues themselves.<sup>39</sup> Hence we would predict that legislative intervention is highly likely in response to populist law reform demands.

However, such an outcome would be inconsistent with the wishes of both the interest groups that would ordinarily be steering business law reform and the subordinate lawmakers that would be supplying it. The former stand to lose whatever they have at stake in the outcome; the latter potentially stand to lose their jurisdiction to make future rules. Hence it may be in the interests of both groups to preempt populist measures by “solving” the problem in a way calculated to defuse its political salience. This might be done by identifying an issue that may become (or is starting to become) salient early on, and focusing attention on subordinate lawmakers to produce a “solution.” We will see examples of this phenomenon at work in the creation of takeover law in both developed and emerging markets.

Of course, the production of business law need not be delegated to a single subordinate lawmaker. Often, multiple subordinate lawmakers share jurisdiction over a regulatory space, or an agency lacking clear formal authority may nonetheless insert itself into a regulatory space hoping to expand its influence.<sup>40</sup> The actual or potential participation of multiple lawmakers, responsive to different interests, fuels regulatory competition which shapes the production of business law around the world.<sup>41</sup>

Table 1 below summarizes this discussion, indicating the likelihood that each of the four lawmaking institutions described above would respond to each of the three channels of demand for business law reform. Some basic predictions follow from the analysis: First, interest groups will seek out the most responsive regulator in responding to new issues that novel market transactions raise. Second, courts will rarely be the most responsive regulator. Third, it is generally in the interest of both interest groups and

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38. See sources cited *supra* notes 32–36.

39. See *supra* text accompanying notes 11–15.

40. See, e.g., Edward J. Kane, *Regulatory Structure in Futures Markets: Jurisdictional Competition Between the SEC, the CFTC, and Other Agencies*, 4 J. FUTURES Mkts 367, 369 (1984).

41. There is a vast literature on regulatory competition in the production of business law in the United States and the European Union (“EU”). See, e.g., John Armour, *Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition*, in 58 CURRENT LEGAL PROBS. 369, 370–71 (Jane Holder & Colm O’Cinneide eds., 2006) (arguing that member states rather than the European Commission should make European corporate law); Mark J. Roe, *Delaware’s Competition*, 117 HARV. L. REV. 588, 592 (2003) (noting that the U.S. government helps to create competition for Delaware in corporate lawmaking). On regulatory competition in less developed legal systems, see, for example, Erica Fung, *Regulatory Competition in International Capital Markets: Evidence from China in 2004–2005*, 3 N.Y.U. J. L. & Bus. 243, 251, 300–01 (2006).

subordinate lawmakers in the form of agencies and private actors to preempt populist legislation by arriving at a “solution” to a new issue before it takes on political salience sufficient to spark legislative activity. These predictions follow straightforwardly from the model, and are borne out in the historical evolution of takeover regimes in both developed and emerging markets that we examine in the succeeding Parts of the Article.

TABLE 1 MODES OF BUSINESS LAW REFORM

	Legislature	Courts	Regulators	Private Actors
<b>Individuals / firms</b>	Unresponsive	Somewhat responsive	Unresponsive	Unresponsive
<b>Interest Groups</b>	Responsive, but delegates	Unresponsive	Somewhat responsive	Responsive
<b>Public at Large</b>	Responsive	Unresponsive	Pre-emptive	Pre-emptive

From the discussion so far, we may predict that the greater the opacity of business issues to the general population, the more likely it is that a pre-emptive regulatory “solution” will conform to the preferences of the dominant interest group. Initially, this gives little guidance as to the *form* such solutions might take. However, as we shall see, where the new activity has already been encountered in other jurisdictions, the rules adopted in these other jurisdictions can become a focal point for establishing “best practices.” Where the same activities arise later in other jurisdictions, rules proposed preemptively may be expected to resemble, at least superficially, the pre-established best practice. This is because failure to follow best practice might lead to the inference that insiders are adopting a solution favorable to themselves. This yields a prediction regarding the form of rules: they may be expected to draw heavily upon measures already adopted in other jurisdictions. Again, this prediction is borne out when we turn to actual examples of recent hostile takeover law development.

We now turn from an abstract model of business law reform to the initial focus of our inquiry in this Article: the development of hostile takeover regimes in the United Kingdom, the United States, and Japan.

## II. HOSTILE TAKEOVERS AND DEFENSES IN THREE MAJOR ECONOMIES

In this Part we survey the development of hostile takeovers and their regulation in the United Kingdom, the United States, and Japan. In each

case, we ask: When did hostile takeovers emerge in that country, and why at that particular time? What pre-existing legal rules were available to govern such transactions? How and why did the institutional framework for regulating takeovers change in response to the emergence of hostile bids? Here we frame the answers in historical perspective to provide readers with a basic exposition of the facts. In Part III, we draw on the analytical framework to illuminate the underlying dynamics driving the historical evolutionary paths.

### A. *The United Kingdom*

#### 1. *Why did hostile takeovers emerge in the United Kingdom?*

The history of hostile takeovers in the United Kingdom began in the early 1950s. Soaring post-war inflation had caused real estate values to rise rapidly,<sup>42</sup> while the Companies Act 1948 had enhanced the quality of financial reporting by public companies.<sup>43</sup> These circumstances enabled investors such as Charles Clore, the successful bidder in the first hostile takeover in 1953, to determine that target firms were substantially undervaluing their retail premises by entering them in their accounts at book rather than market value.<sup>44</sup> It seems that this new information was not immediately impounded into share prices, because investors in U.K. public companies, long used to valuing securities on the basis of very limited financial information, relied upon the regular dividends as a credible signal of management's commitment to investors.<sup>45</sup> Dividend yields were therefore a key determinant of securities prices.<sup>46</sup> In the immediate post-war era, the U.K. government imposed dividend restrictions on public companies to encourage reinvestment in the companies themselves.<sup>47</sup> Because of the way in which securities were valued, this policy depressed stock prices. The coalescence of these factors created exceptional opportunities for asset arbitrage: stock prices based on restricted dividends fell far below the market value of inflated real estate owned by target companies.

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42. See, e.g., *Mergers Take Over*, *ECONOMIST*, July 4, 1959, at 41.

43. Cf. Les Hannah, *Takeover Bids in Britain Before 1950: An Exercise in Business "Pre-History"*, 16 *BUS. HIST.* 65, 75–76 (1974) (suggesting that informational constraints existed under the 1948 Companies Act).

44. But see *City Notes: The J. Sears Offer*, *TIMES* (London), Feb. 5, 1953, at 10 (suggesting that properties were not in fact undervalued).

45. Cf. 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) (suggesting that payment of dividends had a supplemental, rather than primary, role in the separation of ownership and control).

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

47. See 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.



2. *How were contemporary corporate disputes resolved in the United Kingdom?*

In the early 1950s, there were three existing routes in Britain by which intra-corporate disputes could be resolved. One was a shareholder suit. However, this was subject both to restrictive standing rules and problems associated with funding litigation.<sup>48</sup>

Second, recourse could be had to an administrative inquiry by the Board of Trade.<sup>49</sup> During the 1950s, this mechanism was employed in a number of cases where there was a public outcry about the management of a particular company's affairs. One example was the notorious battle for Savoy Hotel Ltd. in 1953, wherein the incumbent board used an asset lock-up strategy to frustrate a bid<sup>50</sup> without consulting their shareholders. The subsequent outcry led to an investigation by the United Kingdom's Board of Trade.<sup>51</sup> Although the resulting report concluded that the board's conduct was not compatible with their fiduciary duties,<sup>52</sup> it lacked the force of law, so such conduct continued to occur.<sup>53</sup>

Third, shareholders could take action to discipline managers by exercising voting rights. The Companies Act 1948 had authorized a series of measures designed to strengthen the position of shareholders vis-à-vis boards.<sup>54</sup> These were prompted by findings that share ownership in U.K. publicly traded companies was becoming widely dispersed, and consequently large shareholders' ability to monitor management was declining.<sup>55</sup>

A fourth salient aspect of corporate dispute resolution was the consensus-based method of doing business that operated in post-war Britain. The City of London had long been said to operate in the manner of a "private members' club," with influential players meeting each other regularly in a num-

48. John Armour, *Enforcement Strategies in U.K. Corporate Governance*, in RATIONALITY IN COMPANY LAW: ESSAYS IN HONOUR OF DD PRENTICE 71, 112–15 (John Armour & Jennifer Payne eds., 2009).

49. See Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 165(b) (Eng.) (granting Board power to intervene unilaterally); R. D. Fraser, *Administrative Powers of Investigation into Companies*, 34 MOD. L. REV. 260, 260 (1971).

50. The bidder intended to convert the company's Berkeley Hotel into commercial offices. The Savoy board arranged for the Berkeley to be sold and leased back to the company on terms that required it to be used as a hotel. *Battle for the Savoy*, ECONOMIST, Dec. 12, 1953, at 831; *Savoy Group's New Company*, TIMES (London), Dec. 7, 1953, at 17.

51. See *Battle for the Savoy*, *supra* note 50, at 831.

52. E. MILNER HOLLAND, 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. 26 (1954).

53. See *infra* Part II.A.0.

54. See Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 184 (Eng.) (adopting a mandatory rule that a company may remove a director by ordinary resolution).

55. BOARD OF TRADE, REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT, 1962, Cmnd. 1749, ¶ 105 (U.K.), (quoting BOARD OF TRADE, REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT (THE COHEN REPORT), 1945, [Cmd.] 6659, ¶ 124 (U.K.)). Shortly afterward, the impact of post-war taxation led to a significant shift in share ownership away from individuals in favor of institutional investors. See BRIAN R. CHEFFINS, CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED 325 (2008).

ber of different contexts.<sup>56</sup> In this environment, reputational sanctions could operate more powerfully than in a society where the relevant “players” were more anonymous, and in their interactions, more intermittent.<sup>57</sup>

### 3. *Controversy and conflict*

Members of the British business community, particularly the boards of target companies, were outraged by the temerity of hostile bidders, and some managers felt justified in defending themselves as the Savoy board did.<sup>58</sup> Not until the end of the 1950s, however, did a battle for corporate control yield a concrete regulatory development.

Arguably, the pivotal contest in the history of British takeover regulation was the battle for British Aluminium in 1958. The firm’s board was approached in secret by two potential acquirers. It rejected one suitor and agreed to issue new shares amounting to a one-third stake in the firm to the other.<sup>59</sup> All this was made public when the rejected bidder then made an offer directly to British Aluminium shareholders.<sup>60</sup> Shortly afterward, a group of institutional shareholders resolved 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.<sup>61</sup> As *The Times* commented: “[T]he institutions often become in effect spokesmen for all the shareholders. [They] have a large interest in British Aluminium’s . . . share capital, so that their votes—as well as their example—must have an important effect on the final result.”<sup>62</sup> Not only did this result in the failure of the British Aluminium board’s preferred deal,<sup>63</sup> but several other companies announced that in the future they would not issue significant blocks of stock without shareholders’ consent.<sup>64</sup> Institutional shareholders had now become a force to be reckoned with.

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56. See generally 4 DAVID KYNASTON, *THE CITY OF LONDON* (2001) (narrating the City of London’s history from 1945–2000); 2 DAVID KYNASTON, *THE CITY OF LONDON* (1995) (narrating the City of London’s history from 1890–1914).

57. See generally sources cited *supra* notes 26–29.

58. See *supra* text accompanying note 50.

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

60. *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.

61. *No Early Move on Aluminium*, *TIMES* (London), Dec. 5, 1958, at 12; *No Early Official Decision on British Aluminium*, *TIMES* (London), Dec. 5, 1958, at 19.

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

63. *War to What Purpose?*, *ECONOMIST*, Jan. 10, 1959, at 145; see also STAMP & MARLEY, *supra* note 47, at 7–8.

64. *British Aluminium Reply*, *TIMES* (London), Dec. 20, 1958, at 12.

#### 4. *Writing rules to govern takeovers*

The British Aluminium affair provoked a number of calls for takeover regulation.<sup>65</sup> In July 1959, the Governor of the Bank of England secretly invited a committee consisting 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.<sup>66</sup> Consistently with our theoretical framework, this initiative seems to have been prompted by fear that the matter would otherwise be taken out of the City's hands by legislation.<sup>67</sup> In the autumn of 1959, the Bank's committee announced its adoption of the *Notes on Amalgamation of British Businesses* ("Notes"), which contained a series of general guidelines that were "concerned primarily to safeguard the interests of shareholders"<sup>68</sup> and that apparently had the effect of heading off demands for legislative intervention.<sup>69</sup> The principle of shareholder primacy—and correlative board neutrality—was thus established.

#### 5. *Adjudicating and enforcing the rules*

Although the Notes were well-received, they lacked mechanisms for adjudication and enforcement of the rules they set out. Problems resurfaced in takeover battles in the late 1960s.<sup>70</sup> Although many thought a governmental agency with oversight authority, along the lines of the U.S. Securities and Exchange Commission ("SEC"), was inevitable,<sup>71</sup> the Bank of England instead reconvened its Working Party to begin drafting a new set of take-

65. See 606 PARL. DEB., H.C. (5th ser.) (1959) 21–22 (U.K.) (Mr. Sydney Irving MP 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.").

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

67. See sources cited *supra* note 65.

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

69. 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 stay open for a minimum of twenty-one days and the disclosure of certain information about bidders. *New Rules for Take-Over*, 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 generally BOARD OF TRADE, REPORT OF THE COMPANY LAW COMMITTEE, 1962, [Cmd.] 1749 (U.K.).

70. These included a battle for control of Metal Industries Ltd. in 1967, where the tactics were similar to those used in the British Aluminium fight almost a decade earlier. See, e.g., Sandy McLachlan & Philip Jacobson, *Thorn Deal with MI Strips Control Away from Aberdare*, TIMES (London), July 17, 1967, at 17; *All for the Lack of a Referee*, TIMES (London), July 17, 1967, at 21; *Back to the Jungle*, ECONOMIST, July 22, 1967, at 337. 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.

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

over rules.<sup>72</sup> The result was the *City Code on Takeovers and Mergers* (“City Code”)—very much in the same shareholder-oriented spirit as the earlier Notes, but also inaugurating the City Panel on Takeovers and Mergers (“Panel”), tasked with “adjudicating” disputes.<sup>73</sup> The actions of the Working Party, consisting almost exclusively of bankers, lawyers, and institutional investors,<sup>74</sup> can again be seen as an example of preemption by interest groups of potential legislative intervention. The proportion of U.K. publicly traded companies’ shares held by institutional investors had been growing steadily since the early 1950s and, as a result, such institutional investors were a very influential voice in the formation of the City Code.<sup>75</sup>

The London 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. These and the trade associations represented in the Working Party all agreed to impose sanctions upon their members if asked to do so by the Panel.<sup>76</sup>

#### 6. *Subsequent history*

Once the Panel had established its authority, the new system of governance for takeover disputes proved remarkably enduring. To be sure, there were amendments to the City Code. These included the introduction in 1972 of the so-called “mandatory bid rule,” which obligates a party that acquires “control” (defined as thirty percent of the voting shares) of a publicly traded company to make an offer for the remaining shares at the most favorable price paid for shares during the preceding six months.<sup>77</sup> Even the United Kingdom’s recent implementation of the EU-wide Takeover Directive did little to change the structure.<sup>78</sup> The Directive requires takeovers to

72. 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.

73. THE PANEL ON TAKEOVERS AND MERGERS, REPORT ON THE YEAR ENDED 31ST MARCH 1969, at 3, 7–8 (1969) (U.K.) [hereinafter PANEL ON TAKEOVERS AND MERGERS 1969 REPORT].

74. 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 Funds and the Confederation of British Industry. See PANEL ON TAKEOVERS AND MERGERS 1969 REPORT, *supra* note 73, at 2; *Issuing Houses Prepare Code*, TIMES (London), July 22, 1967, at 15.

75. See Armour & Skeel, *supra* note 10, at 1767–76.

76. THE PANEL ON TAKEOVERS AND MERGERS, THE CITY CODE ON TAKEOVERS AND MERGERS App. (1969) (U.K.); see also *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.*

77. THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER CODE, R. 9.1 (2010) [hereinafter THE TAKEOVER CODE 2010]. On the history, see *New Takeover Code Rule: Buyer Gaining 40pc Stake Must Bid for Remainder*, TIMES (London), Jan. 19, 1972, at 17. The “control” threshold was originally forty percent, and was lowered to thirty percent in 1974. *Revised City Code Sets Out New Rules on Mandatory Bids*, TIMES (London), June 6, 1974, at 19.

78. Directive 2004/25, of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L 142) 12 [hereinafter EU Takeover Directive]. Certain parts of the Directive impose

be adjudicated by a public authority or other body “recognized by national law.”<sup>79</sup> The Panel, as a self-regulatory organization, ostensibly does not qualify. The U.K. government, therefore, created a statutory basis for the Panel.<sup>80</sup> However, this change to the Panel’s status has not affected its *modus operandi*. Most importantly, the processes by which members of the Panel are appointed, and their professional backgrounds, have not appreciably changed.<sup>81</sup>

The endurance of the Panel appears to have been a function of the speed with which it has been able to respond to developments in the market for corporate control—developments that, if left unchecked, might have generated political salience and a demand for more wide-ranging legislative intervention. Indeed, its first Chairman, Lord Shawcross, well understood the significance of political salience; in a 1976 report, he explained that the Panel saw its role as being not simply to respond to but also to preempt crises to ensure that there was never any effective call for formal regulatory intervention.<sup>82</sup>

We attribute the Panel’s formation and continued operation to a process of repeated preemption, by influential interest groups, of populist calls for legislation. Throughout the Panel’s history, the most significant of these interest groups has been domestic institutional investors. While levels of institutional ownership of U.K. shares grew from the early 1950s through to the early 1990s, the proportion held by domestic institutions has since fallen back.<sup>83</sup> As a result, one might anticipate that the influence of these investors on takeover rules might decline.

While the Panel’s structure and operation have not changed to date, this may no longer be a stable position. The high-profile hostile takeover of the U.K. company Cadbury PLC by the U.S. firm Kraft Inc. saw much criticism of the successful bidder’s plans for the English workforce<sup>84</sup> and calls for changes to takeover rules to make it more difficult for foreign firms to suc-

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mandatory rules, whereas others are optional. *See, e.g., id.* arts. 5–8 (mandatory bid and promulgation of information relating to bids made applicable to all Member States); *id.* arts. 9(2), 11, 12 (board neutrality and “breakthrough” rules made optional). Both the mandatory rules, and the United Kingdom’s implementation of the optional rules, are largely consistent with the Takeover Code. *See* PANEL ON TAKEOVERS AND MERGERS, THE IMPLEMENTATION OF THE TAKEOVERS DIRECTIVE: PROPOSALS RELATING TO AMENDMENTS TO BE MADE TO THE TAKEOVER CODE, Panel Consultation Paper 2005/5.

79. EU Takeover Directive, *supra* note 78, art. 4.

80. *See* Companies Act, 2006, c. 46, pt. 28 (Eng.).

81. *See* The Takeover Panel, Panel Membership, <http://www.thetakeoverpanel.org.uk/structure/panel-membership> (last visited Sept. 26, 2010).

82. *See* THE PANEL ON TAKEOVERS AND MERGERS, REPORT ON THE YEAR ENDED 31ST MARCH, 1975 AND 1976 at 3–4 (1976) (U.K.).

83. Armour & Skeel, *supra* note 10, at 1768–69; CHEFFINS, *supra* note 55, at 382–404.

84. Kraft pledged to keep open a British factory, only to announce one week after the transaction closed that this would not be possible. *See, e.g.,* Michael Carolan, *Kraft’s Disregard for Cadbury Workers*, WALL ST. J. (Mar. 8, 2010, 3:36 PM), <http://blogs.wsj.com/source/2010/03/08/krafts-disregard-for-cadbury-workers>; Elizabeth Rigby & Brooke Masters, *Kraft is Censured on bid for Cadbury*, FIN. TIMES (London), May 27, 2010, at 15.

ceed in acquiring U.K. companies.<sup>85</sup> This has led the Panel to consider wide-ranging reforms, including whether the basic principle of shareholder decisionmaking over takeovers should be relaxed so as to disenfranchise certain “short-term” shareholders.<sup>86</sup> The Panel subsequently announced a string of changes, although not to this fundamental principle.<sup>87</sup> However, the subsequent announcement by the United Kingdom’s Business Secretary of a government review of this and related corporate governance issues<sup>88</sup> suggests that the Panel’s ability to succeed in preempting populist legislative intervention may seriously be called into question.<sup>89</sup> This would, however, be consistent with the reduction in influence of the previously dominant interest group, domestic institutional investors.

### B. *The United States (Delaware)*

#### 1. *Why did hostile tender offers emerge in the United States?*

In the United States there are, generally speaking, two primary methods for an acquirer to obtain control of a publicly held corporation without the consent and cooperation of the target company board. The first is a proxy contest; the second is a hostile tender offer. Recently, both methods have been combined as part of a unified hostile takeover strategy.

Until the 1960s, the primary method to force a change of corporate control in the United States was to wage a proxy contest to replace the target company board.<sup>90</sup> In that setting, the primary regulators were the SEC and the federal courts applying federal law, specifically § 14(a) of the Securities Exchange Act of 1934 and the implementing SEC Proxy Rules.<sup>91</sup> That fed-

85. See, e.g., Amy Wilson & Jonathan Russell, *Kraft to Close Cadbury Plant It Suggested Keeping Open*, DAILY TELEGRAPH (LONDON), Feb. 10, 2010, at 5; *Kraft Deal Shows Buyout Rules Need Change, Says City Minister Lord Myners*, EVENING STANDARD (LONDON), Mar. 9, 2010.

86. TAKEOVER PANEL CODE COMM., REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS, PANEL CONSULTATION PAPER 2010/2, at 20–30 (2010), available at <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201002.pdf>.

87. TAKEOVER PANEL CODE COMM., REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS, PANEL STATEMENT 2010/22, at 7 (2010), available at <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2009/12/2010-221.pdf>.

88. DEPARTMENT FOR BUSINESS, INNOVATION & SKILLS, A LONG-TERM FOCUS FOR CORPORATE BRITAIN, URN 10/1225, at 5 (Oct. 25, 2010), available at <http://www.bis.gov.uk/assets/biscore/business-law/docs/10-1225-long-term-focus-corporate-britain.pdf>.

89. In an interview given to the *Sunday Telegraph* newspaper, U.K. Business Secretary Vince Cable stated that it was his intention to “consult properly, not just as [the Takeover Panel] did predominantly amongst the people in the City who are in the takeover business but amongst business more widely.” Kamal Ahmed, *Cable in ‘Cadbury Law’ Push; Government Inquiry into Takeover Speculators Coalition to Launch Drive for Private Sector Growth End to ‘Short-Termism,’* SUNDAY TELEGRAPH (LONDON), Oct. 24, 2010, at B1.

90. See RANDALL S. THOMAS & CATHERINE T. DIXON, ARANOW & EINHORN ON PROXY CONTESTS FOR CORPORATE CONTROL § 1.01[A], 1-6-1-8 (3d ed. Supp. 2001) [hereinafter “ARANOW & EINHORN”]. Another frequently used technique was to engage in a “street sweep,” attempting to acquire a controlling block through rapid and coordinated buying in the market. See John Armour & Brian Cheffins, *Offensive Shareholder Activism in U.S. Public Companies, 1900–49*, 39–44 (Univ. of Cambridge/Univ. of Oxford, Working Paper, 2009).

91. See 15 U.S.C. §§ 78a–78n (2010); 17 C.F.R. § 240.14a (2010).

eral framework was, and still is, the primary source of proxy contest regulation, with the involvement of state courts being limited to lawsuits for relief against an incumbent target company board's inequitable action to frustrate its shareholders' right to elect a new board.<sup>92</sup>

Beginning in the mid-1960s, the hostile tender offer gradually displaced the proxy contest as the preferred mechanism for acquiring corporate control.<sup>93</sup> This change came about partly because of the relatively greater speed with which the acquisition could be consummated, the hostile acquirer's ability to bypass the board and deal directly with target stockholders, and the unsuccessful acquirer's ability to recoup the expenses of a failed offer by selling its target company stock.<sup>94</sup>

The most important advantage of the tender offer as a takeover device, however, was its comparatively lower cost,<sup>95</sup> a byproduct of three economic and market developments that converged during this period. The first was the emergence of institutional investors, including "arbitrageurs," whose investment horizons were short term and whose aggregate share of the nation's equity markets grew significantly between 1960 and 1980. Whereas in 1951 individuals owned between seventy-five percent and eighty-five percent of all outstanding corporate equities in the United States, by 1979 institutional investors as a group owned over thirty-six percent,<sup>96</sup> and by 1990 the level of institutional ownership exceeded fifty percent.<sup>97</sup> The second development was the depressed stock market price of U.S. corporations in relation to their asset values, making acquiring corporate control in the stock market cheaper than purchasing the company's assets directly.<sup>98</sup> The third condition was the ready availability of investment capital. During the 1970s and 1980s, that capital took the form of subordinated, high interest unsecured debt (so-called "junk bonds") issued by the hostile acquirer. The

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92. See, e.g., *Schnell v. Chris Craft Indus., Inc.*, 285 A.2d 437, 438 (Del. 1971) (invalidating, as inequitable board conduct, a by-law amendment advancing the annual stockholders meeting date and thereby unfairly shortening the dissident shareholders' ability to wage a proxy contest to replace the board); see also *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 652 (Del. Ch. 1988) (invalidating board action expanding the board by two directorships and then filling the two vacancies, thereby making it impossible for dissident slates in proxy contest to gain majority board control); *Lerman v. Diagnostic Data, Inc.*, 421 A.2d 907, 914 (Del. Ch. 1980) (invalidating an advance notice by-law that no dissident slate could comply with in a timely way to become eligible to wage a proxy contest for board control).

93. Samuel L. Hayes III & Russell A. Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV. 135, 136-37 (1967).

94. ARANOW & EINHORN, *supra* note 90, at § 1.01[B], 1-9.

95. *Id.* at § 1.01[B], 1-9 n.23 ("As the costs of proxy contests escalated in the 1950s and 1960s, the cash tender offer began to supplant the proxy contest as the preferred takeover vehicle because substantial influence could be purchased with relatively low transaction costs.") (internal citations omitted) (internal quotation marks omitted).

96. *Id.* at § 1.01[A], 1-7.

97. *Id.* at § 1.01[C], 1-13.

98. WILLIAM J. CARNEY, *MERGERS AND ACQUISITIONS* 4 (2d ed. 2000). See also Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 106-09 (1979). Similar economic conditions in the United Kingdom were a major contributing factor driving the emergence of takeovers in the United Kingdom. See Section II.A.1, *supra*, at 19-20.

result was that the currency used for many hostile acquisitions was typically unsecured credit.<sup>99</sup>

## 2. *The federal regulatory framework*

Until 1968, tender offers were often strategically abusive, to the detriment of target company stockholders. Acquirers offered short-term, high-price deals on a “first-come first-served” basis, exacerbating target shareholder fears that if they did not act quickly they would be left holding illiquid stock and be vulnerable to a “squeeze out” merger at a lower price. Indeed, the purpose and effect of this tactic was to stampede target company shareholders into tendering their shares to the hostile bidder, even if the offering price was unfairly low, and, given the short period of time available to respond, to prevent target company boards from taking any meaningful defensive action.

In 1968, the U.S. Congress responded to these abuses by adopting the Williams Act, a statute that imposed important disclosure and procedural requirements for tender offers.<sup>100</sup> Unlike the U.K. regime, the Act did not require a party that acquired a controlling stake by means of a block purchase to make a “mandatory bid” for all shares so as to give the minority stockholders a chance to exit their investment.<sup>101</sup> Nor did the Williams Act regulate the conduct of target company boards in responding to and resisting hostile takeover bids; at the federal level there was no governmental interest in regulating anti-takeover defensive measures.<sup>102</sup> The consequence was to leave the regulation of board anti-takeover defensive conduct to the states, and particularly, state courts. Because Delaware was, and continues to be, the state where a majority of large public U.S. companies are incorporated, the conduct of these corporations’ directors became subject to regula-

99. After the collapse of the junk bond market in the early 1990s, due primarily to the demise of Drexel Burnham Lambert, the form of acquisition currency changed, and became the acquirer’s own equity and debt securities. This was attributable, in large part, to the significant increase in overall stock market prices between 1995 and 2008. See ARANOW & EINHORN, *supra* note 90, at § 1.01[B], 1-11.

100. 15 U.S.C. §§ 78m-78n (2006). See also STEPHEN M. BAINBRIDGE, *MERGERS AND ACQUISITIONS* 288-89 (1st ed. 2003); CARNEY, *supra* note 98, at 927-29.

101. See THE TAKEOVER CODE 2010, *supra* note 77, § F, at 1.

102. As Chancellor William Chandler of the Delaware Court of Chancery has observed:

With minor exceptions, the United States Congress had shown no interest in adopting a statutory framework to regulate corporate decisionmaking. The [SEC] also expressed no interest in regulating takeover defenses such as the poison pill. Moreover, the United States Supreme Court had essentially sidelined federal judges and state legislatures with respect to such corporate governance matters. Almost by default, state courts were left to fill this void and create dependable ground rules governing when corporate boards . . . might employ takeover defenses . . . to deter, thwart, slow down or even stifle an ever-increasing wave of hostile acquisitions . . . . As the state of incorporation of a substantial majority of United States corporations, Delaware was thrust into the forefront to develop these ground rules.

William B. Chandler III, *Hostile M&A and the Poison Pill in Japan: A Judicial Perspective*, 2004 COLUM. BUS. L. REV. 45, 49-50 (2004).



tion under Delaware law, administered by the Delaware courts on a case-by-case basis.<sup>103</sup>

### 3. *New Delaware fiduciary doctrines for regulating takeover defenses*

Even when the Delaware courts began developing this area of corporate law in a systematic way in 1985, two fundamental corporate law issues remained unresolved. The first was who should decide whether an unsolicited takeover bid could go forward: the stockholders or the target company board? The second was which governmental branch—executive, legislative, or judicial—should decide the first question? Expressed in terms of our analytical model, the second question addressed which lawmaker should have authority to allocate the power to decide the first question as between the stockholders and the board.

For Delaware, the legislative branch was never a realistic option. Tender offers and target board responses were nowhere addressed in Delaware's corporate statute, and (consistent with the theoretical framework set out in Part I) the Delaware legislature had never expressed any interest in becoming a prime actor in this arena. Nor had the executive branch; in contrast to the United Kingdom's reliance on the Panel, no Delaware administrative agency or self-regulatory body was charged with regulating board conduct, as that role had historically been the province of the Delaware courts. Nor was there any history or tradition of private market actors fulfilling that regulatory role. Thus, by default more than anything else, the regulation of board anti-takeover defensive conduct became centered in the Delaware courts, whose basic tools were common law fiduciary principles applied on a case-by-case basis.<sup>104</sup> It was within this institutional framework that the law regulating takeover defenses of Delaware corporations developed and continues to evolve.

Once it was settled (in Delaware at least) that the courts would be the governmental institution charged with determining how corporate boards may properly respond to a hostile takeover bid, these courts proceeded to

103. Delaware, like over thirty other states, adopted a so-called "antitakeover statute," DEL. CODE ANN. tit. 8, § 203 (2010), but this statute neither regulated takeover defenses in any comprehensive way nor filled the regulatory vacuum that the state courts would soon occupy. Nor did any Delaware administrative agency have the jurisdiction to regulate, or manifest any interest in regulating, target board responses to hostile takeover bids. See generally BAINBRIDGE, *supra* note 100, at 252.

104. One possible explanation for why fiduciary duty judicial review ended up as the default regulatory mechanism in the United States is the absence of any detailed federal or state regulatory regime at that time. More specifically, if there were in place a federal (or state) statute requiring tender offers to be structured for all outstanding shares and for a fair price, that would have precluded the two-tier, coercive offers that were prevalent in the mid-1980s, and might well have resulted in an entirely different takeover jurisprudence. Because no such statutory requirements existed, target company boards had a reasonable basis for taking defensive actions in response to the original wave of coercively structured offers. That, in turn, generated the need for a decisionmaker to perform a contextual review of whether or not the defensive board action was proper. In this highly idiosyncratic environment, the Delaware courts were ideally suited to perform that role.

decide the two fundamental questions described above: whether the target company board or its stockholders should decide whether a hostile bid should proceed, and which governmental branch should decide the first question.

*a. Who decides whether a hostile takeover bid will go forward?*

The first question—which body, the board or the stockholders, should decide whether or not to entertain a hostile takeover bid—had no clear answer. If the bid took the form of a merger proposal, the Delaware General Corporation Law (“DGCL”) affirmatively empowered the board to decide whether the shareholders could vote on the transaction.<sup>105</sup> If, however, the transaction took the form of a tender offer, no such statutory power was vested in the board. Indeed, the statute did not address tender offers at all. Moreover, because a tender offer was, in form at least, a transaction between the bidder and the target shareholders, some legal commentators concluded that the board should play no role and that the shareholders alone could and should decide whether to accept or reject the offer. Other legal commentators argued, with equal fervor, that the board should decide.<sup>106</sup> Not until 1985, in *Unocal*,<sup>107</sup> did the Delaware Supreme Court resolve that debate. The *Unocal* court decided, as a matter of fiduciary law, that where a target board has reason to regard a hostile bid as a threat to legitimate corporate policy and shareholder interests, the board has both the power and the duty to interpose itself between the offeror and the shareholders and, where necessary, take defensive measures that are not disproportionate to the threat.<sup>108</sup>

The *Unocal* doctrine contrasts markedly with the regulatory approach taken by the United Kingdom in the City Code. As we have seen, the City Code mandates strict neutrality of target boards, prohibits directors from installing defensive measures without shareholder approval, and imposes a mandatory rule requiring bidders that acquire over thirty percent of the target company’s voting rights to extend the offer to all shares of all classes subject to the offer.<sup>109</sup> As we later explain in greater detail, the City Code

105. See DEL. CODE ANN. tit. 8, § 251 (2010) (requiring that the board recommend a merger or consolidation to shareholders before shareholders are entitled to vote).

106. The debate in the United States was driven by two interest groups having diametrically opposite views. Takeover defense lawyers (and some academics) argued that board decisions with respect to tender offers should be treated like any other board decision concerning an acquisition proposal and that the business judgment rule should locate the power to deploy defensive tactics with the board. See Lipton, *supra* note 98, at 103–04; see also Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 818 (2002). The plaintiff’s bar, and many academics, took the position that shareholders should ultimately decide whether a hostile bid will succeed, and that the target board should take a passive role. See 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); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 875–76 (1981).

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

108. *Id.* at 955–57.

109. THE TAKEOVER CODE 2010, *supra* note 77, R. 9.1, 21.1, 25.1.

approach was (in part) the result of two factors that were not present in the United States: the influence of institutional investors, and the strong preference of the U.K. business community for takeovers to be regulated by private, as distinguished from governmental, actors.

*b. Under what standards will the court review board anti-takeover conduct?*

The answer to the first question could not be reached without also answering a related issue: if the board, as fiduciary, was to be the gatekeeper, then by what standard would the courts review whether the board's fiduciary duties were being properly discharged? At that point in the development of U.S. corporate fiduciary doctrine, there existed only two standards of review: the business judgment rule and the entire fairness standard.<sup>110</sup> Under business judgment review, it is presumed that in making a business decision, "the directors . . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."<sup>111</sup> Under entire fairness review, which was applied only in "controller conflict" cases where the board or management stood accused of acting in a self-interested manner, the directors or managers have the burden to demonstrate that their conduct was entirely fair to the corporation and its shareholders, as to both process and price.<sup>112</sup>

Neither standard was especially "well-suited or responsive" to the issues that hostile takeovers presented, first because "board resistance to hostile takeovers, particularly tender offers, did not comfortably fit the paradigms envisioned by those standards,"<sup>113</sup> and second, because their application to hostile takeovers created the risk of being either under- or over-inclusive.<sup>114</sup>

110. Jack B. Jacobs, *Implementing Japan's New Anti-Takeover Defense Guidelines, Part I: Some Lessons from Delaware's Experience in Crafting "Fair" Takeover Rules*, 2 N.Y.U. J. L. & Bus. 323, 328–29 (2006) [hereinafter *Japan's Anti-Takeover Defense Guidelines, Part I*].

111. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

112. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

113. *Japan's Anti-Takeover Defense Guidelines, Part 1*, *supra* note 110, at 329. The business judgment standard "presupposes that the board is making a 'business judgment' that involves the business or assets of the corporation." *Id.* But, as earlier noted, in form a tender offer is a transaction solely between the offeror and the target company stockholders. Under the DGCL a tender offer does not require the board's approval, and arguably does not even involve the corporation's "business" at all. Nor was the entire fairness standard—applied to self dealing transactions with a majority stockholder or to transactions approved by a board having a financial conflict of interest—a good fit for the hostile takeover fact pattern. "Many corporate boards that approved defensive measures against hostile tender offers had a majority of independent directors whose livelihoods (unlike those of 'inside' directors) would not be affected by the outcome of the hostile offer. In such cases, no self-dealing in the classic sense was involved." *Id.*

114. *Id.* For example, "reviewing a takeover defense under the entire fairness standard created a significant risk of being over-inclusive," meaning that the defense would be invalidated simply because the defensive measure would prevent the shareholders from accepting an offer at a premium above the current market price of the target company stock. *Id.* at 329–30. Fairness review would thus create a high risk of depriving target boards of their ability to protect shareholders against coercive, two-tiered offers of the kind involved in *Unocal*. On the other hand, "reviewing a takeover defense under the business judgment standard would almost invariably guarantee its validity, thereby creating the risk of underinclusion." *Id.* at 330. The concern was that courts would "give undue deference to defensive decisions by a

Accordingly, in *Unocal*, and in later landmark decisions, the Delaware Supreme Court broke new conceptual ground by formulating entirely new standards of review—the so-called “intermediate” standards—tailored specifically to regulating defensive board conduct in response to hostile takeovers. Three intermediate standards of review were developed between 1985 and 1988. The *Unocal* standard applies in cases where the board adopts a defense intended to preserve the company’s independence.<sup>115</sup> The *Revlon* standard governs where the board decides, in response to a hostile bid, to sell the company or commit it to a change of control transaction.<sup>116</sup> And finally, the *Blasius* standard controls where the board engages in defensive conduct that intentionally interferes with the shareholders’ voting franchise, in particular, their right to elect a different board.<sup>117</sup> These new review standards are addressed here because they are important to understanding the Japanese response to hostile takeovers.<sup>118</sup>

*Unocal* was a critical conceptual breakthrough in the development of the intermediate standards of review because a court, for the first time, formally acknowledged a unique feature of the hostile takeover paradigm: the “omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders.”<sup>119</sup> That is, hostile takeovers created a *potential* conflict—one not yet actual or provable—that was too elusive to warrant entire fairness review yet also too disquieting to warrant automatic business judgment deference. That insight led the court to craft an intermediate standard of *reasonableness* that requires the board to establish that its defensive actions were objectively reasonable in order for the defense to become entitled to business judgment review. Under *Unocal*, the board must prove that the hostile offer was reasonably perceived as a threat to corporate value and policy, and that the board’s selected defense was not disproportionate to the threat.<sup>120</sup> This standard, by its very nature, lent itself to objective judicial application.

In *Revlon*, the Delaware Supreme Court confronted a different kind of takeover defense that called for a reformulated articulation of the reasonableness standard—a board decision either to sell the company or to cause it to engage in a change of control transaction, rather than keep the company independent.<sup>121</sup> *Revlon* holds that in these circumstances, the board’s fiduciary duty is to sell the company to the bidder that offers to the shareholders

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compliant board that, even though disinterested and acting in good faith and having no personal financial interest in the matter, was servile to the views of senior managers who did have a career-based self-interest in opposing an offer that would benefit the shareholders.” *Id.*

115. See *Unocal*, 493 A.2d at 953–54.

116. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 175–79 (Del. 1986).

117. *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 662–63 (Del. Ch. 1988).

118. See *infra* Part II.C.

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

120. *Unocal*’s reasonableness standard was later rearticulated in *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1373–89 (Del. 1995).

121. See generally *Revlon*, 506 A.2d 173.

the highest value reasonably available.<sup>122</sup> In this setting the court must review the reasonableness of the board's choice of transaction (and transaction partner), as to both process and price, with the board having the burden to prove that its decision was reasonable in both respects.<sup>123</sup>

The third intermediate standard of review (*Blasius*) came about as a result of the "poison pill" anti-takeover defense. The pill was essentially an option (or "right"), created unilaterally by board resolution, that would become distributed to target company shareholders on a one-right-per-share basis ("triggered") if a hostile bidder acquired target company shares exceeding a specified percentage threshold—typically fifteen percent or twenty percent—of the target's outstanding shares. The rights would have no economic value unless and until they became exercisable, which typically would occur only if the bidder actually acquired shares exceeding the "trigger" threshold and/or announced that it would acquire all non-tendered shares in a second-step merger. When exercised, the rights would typically entitle the holder of each right—except the hostile bidder—to acquire two or more shares of the target company for the price of one share.<sup>124</sup> If the rights were exercised, that would massively dilute the bidder's target stock ownership percentage, thereby making economically suicidal any acquisition of the triggering percentage of shares without target board approval.<sup>125</sup>

Not surprisingly, such a potent defense was quickly, though unsuccessfully, challenged in court. In *Moran*, the Delaware Supreme Court upheld the adoption of a poison pill as a pre-planned defense (i.e., where no actual takeover proposal was being made).<sup>126</sup> The court also held that in cases where the pill is used as a defense against an actual hostile bid, the defense would become subject to separate *Unocal* review. Encouraged by the prospect of case-specific reasonableness review, bidders brought lawsuits challenging target boards' deployment of the poison pill as a defense. These challenges proved largely unsuccessful because in most cases, allowing the pill to be kept in place often resulted in higher bids and superior transaction terms compared with the bidder's initial offer. As a result, the poison pill became the defensive mechanism of choice in the United States.<sup>127</sup>

122. This summary actually conflates the review standard as articulated in *Revlon* and the amplification of that standard a decade later in *Paramount Corp. v. QVC Network*, 637 A.2d 34, 51 (Del. 1994).

123. *Paramount*, 637 A.2d at 45.

124. See *Moran v. Household Int'l Inc.*, 500 A.2d 1346, 1348–49 (Del. 1985); *Carmody v. Toll Bros. Inc.*, 723 A.2d 1180, 1186–87 (Del. Ch. 1998).

125. Built into the design of every "rights plan" was a safety valve: it authorized the target company board to exempt any potential acquirer from the operation of the pill, and, if the pill were triggered, the board could redeem the rights at a nominal cost of (say) one cent per share. The clear intent of the poison pill defense was to give potential acquirors every economic incentive to negotiate an acquisition with the board, rather than to "go hostile." See *Moran*, 500 A.2d at 1354.

126. 500 A.2d at 1348.

127. For a more complete exposition of the post-*Moran* history of the poison pill defense, see *Carmody*, 723 A.2d at 1185–87.

That unsuccessful experience forced hostile bidders to adopt new strategies designed to counteract the pill defense. The most effective strategy was to resurrect the proxy contest and combine it with a hostile tender offer. By conducting a proxy solicitation to remove the incumbent target directors and replace them with the bidder's board candidates, the bidder would be assured that its candidates, after their election, would redeem the poison pill. Faced with the prospect of removal, target company boards developed counterstrategies, designed primarily to interfere with, if not obstruct altogether in some cases, the bidder's proxy solicitation.<sup>128</sup> One of these counterstrategies—amending the by-laws to increase the size of the board and then filling the new positions with management-friendly designees, thereby assuring incumbent board control—became the subject of legal challenge in the 1988 *Blasius* case.<sup>129</sup>

In contrast to the *Unocal* and *Revlon* “intermediate” standards, the *Blasius* review standard is not one of reasonableness. Indeed, from the target board's perspective, it is the least deferential standard. Under *Blasius*, if the board's defensive actions amount to an intentional interference with the shareholders' voting franchise (specifically, their right to elect a different board), these actions will be invalidated unless the board can show a “compelling justification” for taking them.<sup>130</sup> The policy justification for this rigorous standard is that the shareholder vote that installs the directors into office is what legitimizes the directors' exercise of corporate power. It is therefore vital that the shareholder franchise be safeguarded against board interference.<sup>131</sup> The *Blasius* standard was designed to enforce that fundamental corporate law principle.

The foregoing discussion of how the U.K. and the U.S. institutional frameworks for regulating board-adopted takeover defenses evolved is necessary background for what follows: how that institutional framework evolved in Japan.

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128. See, e.g., *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 652 (Del. Ch. 1988) (invalidating target board amendment of by-laws to expand the size of the board and appointment of two directors to fill the newly created directorships so that the incumbents retained control irrespective of the outcome of the proxy contest); *Aprahamian v. HBO & Co.*, 531 A.2d 1203, 1205 (Del. Ch. 1987) (invalidating board rescheduling of shareholders' annual meeting to a later date, to enable the board to solicit revocations of proxies to defeat the otherwise victorious dissident group).

129. The *Blasius* review standard was upheld by the Delaware Supreme Court in *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1120 (Del. 2003).

130. *Blasius*, 564 A.2d at 661.

131. See *id.* at 659, 663.

## C. Japan

1. *Why did hostile takeovers emerge in Japan?*

In the post-war period, hostile takeovers in Japan were extremely rare.<sup>132</sup> Their rarity was the product of the post-war corporate governance regime itself, in which publicly traded firms were typically affiliated with a corporate group (*keiretsu*) with a major bank at the center.<sup>133</sup> Group affiliated firms cross-held the shares of their affiliates, forming stable, friendly investor relationships involving significant percentages of the public float. Bank finance predominated during the post-war high growth period. Domestic institutional investor activism as that term is presently understood was virtually nonexistent.<sup>134</sup>

The rise of hostile M&A activity is part of a series of new trends in Japanese corporate governance, driven by deep structural changes in the economy following the bursting of the bubble economy in 1990. Several interrelated developments combined to create a corporate governance environment that differs in significant respects from that which characterized post-war Japan.

First, patterns of share ownership, composition of corporate shareholders, and activism of shareholders in Japan have changed.<sup>135</sup> Japan's severe economic problems and financial system distress in the 1990s caused a loosening of the *keiretsu* corporate group linkages that had characterized post-war corporate structure. Cross-shareholding and stable shareholding practices declined substantially in the 1990s through mid-2000s, as *keiretsu* affiliations grew more tenuous and investors sold off underperforming equity investments.<sup>136</sup> Over this period, share ownership by Japanese financial institutions declined markedly,<sup>137</sup> in significant part due to international capital adequacy requirements and the need to clean up their balance sheets. Meanwhile, foreign ownership of shares (almost exclusively by institutional investors) increased from about ten percent of market capitalization in the mid-

132. Merger and acquisition activity in general was extremely low for an economy of Japan's size. See Curtis J. Milhaupt & Mark D. West, *Institutional Change and M&A in Japan: Diversity Through Deals*, in GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS 295, 296 (Curtis J. Milhaupt ed., 2003) (providing comparative data).

133. See MILHAUPT & PISTOR, *supra* note 12, at 90.

134. See *infra* notes 231–32 and accompanying text.

135. See Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171, 2184–89 (2005) [hereinafter *In the Shadow of Delaware?*].

136. On a value basis, the long-term shareholding ratio declined by twenty percent from the late 1980s to the early 2000s, while the cross-shareholding ratio declined by about ten percent over the same period. See FUMIO KUROKI, THE RELATIONSHIP OF COMPANIES AND BANKS AS CROSS-SHAREHOLDINGS UNWIND—FISCAL 2002 CROSS-SHAREHOLDING SURVEY, Figure 3 (2003), available at <http://www.nli-research.co.jp/english/economics/2003/eco031118.pdf>.

137. By market capitalization, stock ownership by financial institutions declined to thirty-one percent in 2007, from forty-one percent in 1996. The decline was particularly pronounced for banks, whose ownership over the same period declined to less than five percent from fifteen percent. See TOKYO STOCK EXCH., FACT BOOK 2008 65 (2008), available at <http://www.tse.or.jp/english/market/data/factbook/index.html>.

1990s to about twenty-seven percent in 2007.<sup>138</sup> These developments, in turn, helped change the longstanding culture of investor deference to corporate management in Japan: institutional investors—particularly foreigners but also some domestic funds managed under more aggressive foreign models—began to take a more activist stance vis-à-vis corporate management. These investors pressed managers to pay higher dividends and to focus greater attention on measures of financial performance such as return on equity.<sup>139</sup> Amplifying these pressures were several high profile judicial decisions in derivative suits in the early 2000s that highlighted the legal duties of directors to shareholders.<sup>140</sup> Simultaneously, stock market valuations in Japan, beaten down by the protracted recession, created an opportunity for acquirers.

## 2. *What were the pre-existing rules for takeover defenses?*

Given the dearth of hostile takeover activity, it is not surprising that Japan's formal post-war institutional infrastructure for hostile takeovers is best characterized as minimalist. Investor-management disputes (and corporate governance issues generally) tended to be resolved outside the formal legal system.<sup>141</sup> The only legal authority addressing hostile takeovers consisted of a single provision in the securities law and a single strand of judicial doctrine based on a section of the Commercial Code. Under the Securities Exchange Act in effect during this period, a bidder seeking to acquire one-third or more of the shares of a publicly traded corporation was required to make the purchase by means of either market transactions or a tender offer open to all shareholders.<sup>142</sup> Although this provision was inspired by the U.K. City Code, it was not a full-blown mandatory bid rule, as the bidder was not required to bid for all outstanding shares.<sup>143</sup> While the rule was intended as an investor protection mechanism, its major consequence was—perversely—to dampen tender offer premiums.<sup>144</sup>

138. See *id.*

139. See Naohika Baba, *Increased Presence of Foreign Investors and Dividend Policy of Japanese Firms*, 17 PAC. BASIN FIN. J. 163, 164 (2009).

140. The number of shareholder derivative suits against Japanese firms increased markedly after a change to procedural law in 1993 which fixed the plaintiff's filing fee (which is forfeited if the suit is unsuccessful) at a nominal level. See Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351, 352 (2001). Previously, the courts had ruled that the filing fee in derivative suits must be scaled to the amount of damages sought by plaintiffs, often resulting in prohibitively high costs to initiate a suit. *Id.* at 351–53.

141. See Curtis J. Milhaupt, *Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2105 (2001) [hereinafter *Creative Norm Destruction*].

142. See Kenichi Osugi, *Recent Reforms of Japan's Corporate Law in an International Context: Who Have Participated in the Reforms, and How?* 26 (2010) (unpublished working paper) (on file with authors).

143. See *id.*

144. As a result of this rule, a large blockholder seeking liquidity often accepted a below-market price for the shares, in order to dissuade other shareholders from tendering into the offer. See Milhaupt & West, *supra* note 132, at 305.



The judicial doctrine governing defensive measures consisted of a “primary purpose” rule.<sup>145</sup> In the post-war period, the principal defensive measure taken by Japanese firms against an unwanted bid was issuing shares to a white knight, which could be done without shareholder approval. Under the Commercial Code, the issuance could be enjoined at the request of a shareholder if it was “grossly unfair.”<sup>146</sup> The primary purpose rule, developed by the courts in a handful of cases, was that an issuance of stock to a specific shareholder was not grossly unfair if management’s primary purpose was to raise capital rather than to maintain control of the company.<sup>147</sup> Until the mid-2000s, these two rules constituted the entire body of Japanese takeover law. Thus, as one commentator has noted, Japan’s relatively blank institutional slate as hostile takeovers began to occur in the early 2000s is loosely the equivalent of the situation in the United States in the early 1980s, before the development of Delaware takeover doctrine.<sup>148</sup>

### 3. *The new rules*

In 2005, two simultaneous developments significantly altered this institutional landscape. In the spring of 2005, a hostile bid transfixed the Japanese public: an Internet service provider called Livedoor, founded by a brash young entrepreneur,<sup>149</sup> announced an unsolicited bid for Nippon Broadcasting Systems (NBS), a subsidiary of Fuji Television, a prominent broadcasting company.<sup>150</sup> The bid, shocking to the Japanese on several levels, instantly made hostile takeovers a topic of everyday conversation and a matter of serious concern to corporate managers throughout the country.<sup>151</sup> In an attempt to defeat Livedoor’s bid, the NBS board issued to Fuji warrants whose exercise would drastically dilute Livedoor’s stake. Livedoor sued to enjoin the warrant issuance. The Tokyo High Court, in *Nippon Hoso K.K. v. Raibudoa K.K.*,<sup>152</sup> affirmed the District Court’s injunction on the grounds

145. See *In the Shadow of Delaware?*, *supra* note 135, at 2192–93.

146. SHŌHŌ [SHŌHŌ] [COMM. C.] art. 280-10 (Japan), translated in COMMERCIAL CODE OF JAPAN (Nishimura & Partners, trans., Shōji hōmu 2d ed. 2004).

147. See, e.g., Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] July 25, 1989, Hei 1 (yo) no. 2068, 1317 HANREI JIHŌ [HANJI] 28, 35 (Japan). Doctrinally, this rule is similar to U.K. common law.

148. Kenichi Osugi, *Transplanting Poison Pills in Foreign Soil: Japan’s Experiment*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 36, 38 (Hideki Kanda, Kon-Sik Kim & Curtis J. Milhaupt eds., 2008).

149. The brash young entrepreneur, Masafumi Horie, was subsequently convicted of securities and accounting fraud in connection with several of Livedoor’s prior acquisitions. MILHAUPT & PISTOR, *supra* note 12, at 89.

150. Although NBS was clearly a subsidiary member of a media group led by Fuji Television, NBS held 22.5 percent of Fuji, while Fuji held only 12.4 percent of NBS. *Id.* at 88. Fuji was in the midst of a friendly all-cash offer for all of remaining shares of NBS when Livedoor launched its competing bid for the NBS shares. *Id.*

151. For more on the bid, see *In the Shadow of Delaware?*, *supra* note 135, at 2178–80.

152. Tōkyō Kōtō Saibansho [Tokyo High Ct.] Mar. 23, 2005, Hei 17 (ra) no. 429, 1173 HANREI TAIMUZA [HANTA] 125, 125 (Japan).

that the warrant's issuance was "grossly unfair," announcing the following rule:

In principle, where a contest for corporate control has emerged, it constitutes a grossly unfair . . . issuance to issue warrants, the primary purpose of which is for existing management or a specific shareholder who exercises influence over management to retain control, by diluting the holdings of another shareholder. However, where the hostile bidder . . . [has] an abusive motive of exploiting the target, then it is not appropriate to protect the bidder as a shareholder, and if it is clear that the interests of other shareholders will be harmed, issuance of warrants may be permitted as appropriate in order to preserve or protect management's control rights, within the limits of necessity and suitability as to method of resistance.<sup>153</sup>

The *Livedoor* court enumerated four examples of abusive motive: (1) greenmail, (2) "scorched earth" practices involving stripping the target of intellectual property or key customer relationships after the acquisition, (3) liquidation of the target's assets to pay down debt of the acquirer, and (4) selling off assets unrelated to the core business of the target in order to pay a high one-time dividend.<sup>154</sup> Finding insufficient evidence that any of these abusive motives were present in Livedoor's bid, the court concluded that NBS's board had issued the warrants with the primary purpose of preserving management's control. It is noteworthy that the High Court appeared to be grafting a *Unocal*-like threat analysis and proportionality requirement onto the existing "primary purpose" rule.<sup>155</sup>

A second, parallel major development in Japanese takeover policy was culminating just as the *Livedoor* ruling was issued. In 2004, "in light of concerns about the steady rise of hostile bids,"<sup>156</sup> the Ministry of Economy, Trade and Industry ("METI") and the Ministry of Justice ("MOJ") jointly established a Corporate Value Study Group ("CVSG") composed of legal experts and business representatives to consider an appropriate policy response to hostile takeover activity. The CVSG conducted extensive research on Anglo-American takeover defenses and legal precedents and issued a major report in March 2005, in the midst of the Livedoor controversy.<sup>157</sup>

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153. *Id.* at 132–33 (author's translation).

154. *Id.*

155. *In the Shadow of Delaware?*, *supra* note 135, at 2194.

156. KIGYŌ KACHI KENKYŪ KAI [CORPORATE VALUE STUDY GROUP], TEKITAITEKI BAISHŪ BŌEISAKU (KIGYŌ KACHI BŌEISAKU) NO SEIBI [PREPARING DEFENSIVE MEASURES TOWARD HOSTILE TAKEOVERS (MEASURES TO DEFEND CORPORATE VALUE)] 2 (2005) [hereinafter CVSG 2005 REPORT], available at <http://www.meti.go.jp/committee/materials/downloadfiles/g50307a11j.pdf>. An English summary is available at [http://meti.go.jp/policy/economic\\_organization/pdf/shishin\\_hontai.pdf](http://meti.go.jp/policy/economic_organization/pdf/shishin_hontai.pdf). (All citations are to the original report in Japanese).

157. *In the Shadow of Delaware?*, *supra* note 135, at 2195–98.

The report noted that the establishment of defensive measures in Japan had been hampered by uncertainty over their legal effect, a paucity of precedents and experience, and a lack of consensus on what should constitute reasonable defensive measures.<sup>158</sup> It then favorably cited an opinion of the MOJ that “[i]f adjusted for Japanese circumstances, most defensive measures recognized in the [United States] and Europe can also be implemented in Japan.”<sup>159</sup> The report exhaustively analyzed Delaware’s experience with defensive measures, in particular the poison pill, focusing on the *Unocal* rule and its progeny.<sup>160</sup> Again drawing heavily on Delaware jurisprudence, the report discussed ways to ensure and enhance the reasonableness of defensive measures, including retaining the shareholders’ ability to replace the board through a proxy contest, requiring the participation of independent directors and advisors in the formulation of defensive measures, and the advance shareholder approval of defenses.<sup>161</sup>

Significantly, however, the report makes clear that defensive measures should be implemented to protect *corporate value*, a concept that, in the words of one member of the CVSG, is “ambiguous enough to be interpreted either as shareholder interests or as wider interests of the entire body of stakeholders, such as the employees.”<sup>162</sup> Thus, although the CVSG borrowed heavily from Delaware takeover doctrine in formulating its policy recommendations, it also adroitly straddled the conceptual divide between the shareholder orientation of U.S. and U.K. corporate law and the more stakeholder- (particularly employee-) oriented approach of post-war Japanese corporate governance practices.<sup>163</sup>

Based on the report, METI and MOJ jointly issued nonbinding Takeover Guidelines in May 2005.<sup>164</sup> The Takeover Guidelines embrace three fundamental principles: First, adoption, activation, and removal of defensive measures should be undertaken to maintain or improve corporate value.<sup>165</sup> Second, defensive measures should be adequately disclosed when adopted,

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158. CVSG 2005 REPORT, *supra* note 156, at 18.

159. *Id.* at 19.

160. *Id.* at 14–17.

161. *Id.* at 24–29.

162. Osugi, *supra* note 148, at 51.

163. As a formal matter, Japanese corporate law is shareholder-oriented. In fact, Japanese shareholders have more extensive legal rights vis-à-vis the board than their U.S. counterparts. For example, under Japanese corporate law shareholders must approve dividends (Art. 453, 454(1)) and director compensation (Art. 361(1)). KAISHA HŌ [KAISHA HŌ] [COMPANIES ACT], Act No. 109 of 2006, arts. 361, 453–54 (Japan). An English translation is available at <http://www.japaneselawtranslation.go.jp/law/detail/?ft=1&re=02&dn=1&co=01&x=17&y=11&ky=company+law&page=3>.

164. KEIZAI SANGYŌSHŌ [MINISTRY OF ECONOMY, TRADE AND INDUSTRY (METI)] & HŌMUSHŌ [MINISTRY OF JUSTICE], KIGYŌ KACHI, KABUNUSHI KYŌDŌ NO RIEKI NO KAKUHO MATA WA KŌJŌ NO TAME NO BAISHŌ BŌEISAKU NI KANSURU SHISHIN [TAKEOVER DEFENSE GUIDELINES FOR PROTECTING AND ENHANCING CORPORATE VALUE AND THE COMMON INTERESTS OF SHAREHOLDERS] (May 2005) [hereinafter JAPANESE TAKEOVER GUIDELINES], available at <http://www.meti.go.jp/press/20050527005/3-shishinn-honntai-set.pdf>. An English translation is available at [http://www.meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/shishinn\\_honntai.pdf](http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/shishinn_honntai.pdf).

165. *Id.* at 3.

and should be based upon the reasonable will of the shareholders.<sup>166</sup> Third, defensive measures should be necessary and suitable.<sup>167</sup> Perhaps most significantly, the Guidelines note that any defensive measures must comply with the Commercial Code's provisions protecting shareholder equality.<sup>168</sup> But, in a major departure from U.S. law and practice, the Takeover Guidelines endorse (but do not require) advance shareholder approval of defensive measures as a means of ensuring fairness.<sup>169</sup>

The Takeover Guidelines have several noteworthy features, which we raise here and discuss more fully in succeeding sections of the Article. First, despite the gravitational pull of Delaware law on the formulation of a Japanese policy response, the policy framework was developed outside Japan's formal legal system and is not legally binding;<sup>170</sup> the Guidelines are "soft law" in the contemporary parlance of legal academics. Second, the attraction of Delaware doctrine is quite remarkable, given the dearth of judicial involvement in Japanese corporate disputes in the post-war period. One might have expected the Japanese to be drawn more closely to the U.K. City Code, which arguably fits Japan's climate of informal consultation and administrative management better than does the adversarial, court-centered approach of the United States. Third, the involvement of METI in the process is striking: METI lacks formal jurisdiction over the corporate and securities laws of Japan and has insinuated itself into corporate governance issues based on an expansive interpretation of its policy role rather than on any explicit legislative mandate.<sup>171</sup>

With the developments of the Guidelines and the emergence of new judicial doctrine, Japan suddenly had a new, if still incomplete, institutional framework for hostile acquisitions. In 2006 the CVSG observed, "We can say that Japan is changing from [a] situation without rules [for hostile takeovers] to [a] situation with formulated rules."<sup>172</sup>

#### 4. *Subsequent developments: adjudicating and enforcing the rules*

As noted, a key element of the Takeover Guidelines is their endorsement of the shareholder rights plan, a distinctly American takeover defense. Promulgation of the Guidelines sparked a small stampede by Japanese firms to adopt defensive measures. As of July 2009, during the four years since the Guidelines were issued, 567 publicly traded Japanese firms— fifteen per-

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166. *Id.*

167. *Id.*

168. *Id.* at 6–7 n.4.

169. *Id.* at 5–6.

170. *Id.* at 2.

171. *In the Shadow of Delaware?*, *supra* note 135, at 2211.

172. CORPORATE VALUE STUDY GROUP, CORPORATE VALUE REPORT: TOWARD THE FIRM ESTABLISHMENT OF FAIR RULES IN THE CORPORATE COMMUNITY 59 (2006), available at [http://www.meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/houkoku06\\_eng.pdf](http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/houkoku06_eng.pdf)

cent of all companies on the Tokyo Stock Exchange (“TSE”)—adopted a pill-like takeover defense plan.<sup>173</sup>

The actual form that such plans have taken in Japan, however, departs significantly from the poison pill commonly adopted in the United States. The overwhelming majority of Japanese defenses are so-called “pre-warning” [*jizen keikoku*] rights plans.<sup>174</sup> Unlike the U.S. shareholder rights plan, the pre-warning rights plan is not a legal instrument; rather, it is a public statement by the board in the form of a press release setting forth the procedures to be followed should an acquirer contemplate a large-scale acquisition of the company’s shares. The public statement declares that if an acquirer starts an acquisition or takeover bid that would result in the acquirer holding a specified percentage (typically twenty percent) of the target company’s outstanding shares, the target board will establish a special committee to evaluate the bid and consider alternatives. If the committee determines that the acquisition would damage the “corporate value of the company or the common interests of shareholders” (in the typical formulation), it will recommend that the board issue warrants to shareholders other than the bidder.<sup>175</sup>

Japanese defensive measures have quickly taken on this distinctive, and highly uniform, cast due to the influence of another important actor in the takeover landscape: the TSE. After the publication of the CVSG 2005 Report and Takeover Guidelines, the TSE published a series of policy statements and detailed listing standards formally incorporating and effectively enforcing the non-binding principles of the Takeover Guidelines.<sup>176</sup> The TSE began this process by publicly announcing that any listed company considering the adoption of a takeover defense must take into account (1) transparency, (2) the effect on secondary markets, and (3) shareholder

173. Amane Fujimoto et al., *Tekitaiteki baishū bōisaku no dōnyū jōkyō* [*The Status of Adoption of Hostile Takeover Defense Measures*], 1877 SHŌJI HŌMU 12, 13 (2009).

174. TOKYO STOCK EXCHANGE, M&A WO TORIMAKU GENJŌ NI KANSURU TŌSHIKA IKEN NO GAIYŌ: BAISHYŪ BŌEISAKU WO CHŪSHIN NI [OUTLINE OF INVESTOR OPINIONS CONCERNING THE CURRENT STATE SURROUNDING M&A: FOCUSING ON TAKEOVER DEFENSIVE MEASURES] 7 n.13 (2008), available at <http://www.tse.or.jp/rules/seibi/b7gje60000005zf1-att/2008ma.pdf> [hereinafter TSE OUTLINE]. An unofficial English translation is available at [http://www.tse.or.jp/english/rules/ls-improvements/ma\\_investors.pdf](http://www.tse.or.jp/english/rules/ls-improvements/ma_investors.pdf).

175. There are several variations in the process for triggering the issuance of warrants. In some plans, warrant issuance is triggered by simple board resolution; others upon board resolution acting at the recommendation of an independent committee; and in others, upon vote of the shareholders. A second type of shareholder rights plan using a trust structure is also available under Japanese law. Under a trust-type plan, warrants are placed in trust with a trustee, along with instructions to issue warrants to shareholders of record upon the occurrence of specified events, such as the acquisition of a specified percentage of the company’s shares by an acquirer. But as of July 2008, the trust-type plan had been adopted by only seven firms, all of which implemented their plans immediately after the promulgation of the Takeover Guidelines. *Id.* at 7.

176. See, e.g., TOKYO STOCK EXCHANGE, LISTING RULE REVISION WITH REGARD TO THE ADOPTION OF TAKEOVER DEFENSIVE MEASURES (Jan. 24, 2006), available at [http://www.tse.or.jp/english/news/200603/060324\\_a.pdf](http://www.tse.or.jp/english/news/200603/060324_a.pdf); TSE OUTLINE, *supra* note 174, at 10 (reviewing the TSE’s prescriptions of corporate conduct and its delisting criteria).

rights.<sup>177</sup> Specific requirements effectuating each of these principles were then adopted in serial revisions of the TSE's listing standards. To ensure the effectiveness of the listing standards, the TSE requires that firms consult with it before adopting defensive measures. Firms that fail to do so, or whose defensive measures are deemed by the TSE to violate the listing standards, will be identified in a public announcement by the exchange, or ultimately delisted if corrective action is not taken within a specified amount of time.<sup>178</sup> Thus, the TSE's listing rules and policy statements have become the de facto mandatory rules governing takeover defenses for Japanese listed companies. Japanese firms have gravitated overwhelmingly to the pre-warning plan, which is the style of defensive measure favored by the TSE.<sup>179</sup>

Importantly, promulgation of the Takeover Guidelines and the TSE's involvement in the adoption of takeover defenses did not eliminate the role of Japanese courts in takeover-related disputes. Indeed, the first rights plan developed in Japan was immediately challenged by an institutional investor and enjoined by the courts.<sup>180</sup> Moreover, because the pre-warning plan adopted by most Japanese firms lacks legal effect (as it is simply a press release issued before the appearance of any bidders), questions of legal validity may arise when the plan is actually triggered and warrants are actually issued in response to an unsolicited bid, as well as when a company without a pre-warning plan adopts a defensive measure in response to a particular unsolicited bid.<sup>181</sup> The latter scenario generated an important, and highly controversial, judicial decision—the *Bull-Dog Sauce* ruling.

As of May 18, 2007, U.S. private equity fund Steel Partners and its affiliates (the "Steel Partners group") owned 10.25 percent of the outstanding shares of Bull-Dog Sauce, a condiment maker and household name in Japan. On that day, an affiliate of Steel Partners launched a tender offer for all of the company's outstanding shares, which were listed on the second section of the TSE.<sup>182</sup> The board of directors of Bull-Dog Sauce opposed the tender offer and as a defensive measure made a discriminatory allocation of warrants

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177. See TSE OUTLINE, *supra* note 174, at 9.

178. *Id.* at 9–10.

179. See *id.* at 7.

180. See Tōkyō Kōtō Saibansho [Tokyo High Ct.] June. 15, 2005, Hei 17 (ra) no. 942, 1900 HANREI JIHŌ [HANJI] 156, 156 (Japan). The rights plan contained a rather clumsy feature in which nontransferable warrants were vested with shareholders of record as of a specific date. Even if the shares were subsequently sold, the warrants would remain with the seller. If the pill were triggered, investors who purchased shares after the record date would suffer dilution when new shares were issued to former investors who owned shares as of the record date. See *id.* at 163–64. The Tokyo High Court upheld the lower court's grant of an injunction, on the ground that this feature adversely affected pricing and trading of the stock and was unfair to shareholders. See *id.* at 164–65.

181. CORPORATE VALUE STUDY GROUP, TAKEOVER DEFENSIVE MEASURES IN LIGHT OF RECENT ENVIRONMENTAL CHANGES 6 (June 30, 2008) [hereinafter CVSG 2008 REPORT], available at <http://www.meti.go.jp/english/report/data/080630TakeoverDefenseMeasures.pdf> ("[T]akeover defense measures that are adopted after the commencement of a takeover are not the subject of the examination in the Guidelines.").

182. See Saikō Saibansho [Sup. Ct.] Aug. 7, 2007, Hei 19 (kyo) no. 30, 1809 SAIKŌ SAIBANSHO HANREISHŪ [SAIBANREI JŌHŌ] 16, 16 (Japan).

to shareholders.<sup>183</sup> Each warrant was exercisable into one common share of Bull-Dog Sauce. The board allocated three warrants per share to all existing shareholders, including the Steel Partners group. However, the members of this group were the only shareholders prohibited from exercising the warrants for shares; instead, they were entitled to receive only the cash value of the stock into which the warrants would have been exercisable. The proposal was approved by special resolution at the annual shareholders' meeting on June 24, 2007, with 83.4 percent of the outstanding shares voted in favor.<sup>184</sup> As a result, the Steel Partners group would become entitled to a cash payment of just over 2.3 billion yen (about \$18.7 million at then-prevailing exchange rates).

On June 13, 2007, before the annual shareholders' meeting, Steel Partners sought a preliminary injunction to enjoin the warrant issuance. The two principal legal questions were (1) whether the allocation violated the principle of shareholder equality under Japanese corporate law, and (2) whether the defensive measure was unnecessary and unreasonable, and thus "grossly unfair" within the meaning of the corporate law.<sup>185</sup>

The case made its way to the Supreme Court after the District Court's dismissal of the request for a preliminary injunction was affirmed on appeal.<sup>186</sup> The Supreme Court also affirmed, concluding that the warrant issuance was necessary and reasonable.<sup>187</sup> Like the District Court, the Supreme Court reasoned that it is for the shareholders to determine whether damage would arise upon acquisition of control by a particular shareholder. Accordingly, the court should respect the determination of shareholders unless there is a material defect in their decisionmaking process.<sup>188</sup> Given that 83.4 percent of the outstanding voting shares approved the proposal to issue warrants, almost all shareholders of Bull-Dog Sauce other than Steel Partners had agreed that the defensive measure was necessary to prevent damage to corporate value. The allocation of warrants under the circumstances was not unreasonable and thus not "grossly unfair" under the corporate law.<sup>189</sup>

Given the overwhelming shareholder approval of the defensive measure taken by the board, the ruling is not surprising. Indeed, the result would be the same under Delaware and U.K. law. But context is important: one possible effect of the Supreme Court's opinion, which emphasizes shareholder approval as validating a defensive measure, may be to encourage the (re-)establishment of corporate ties to stable, long-term shareholders, so that management can more easily obtain shareholder approval of defensive measures in response to hostile takeover attempts. A full-scale return to group-

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183. *Id.* at 16–17.

184. *Id.* at 17.

185. *Id.* at 17–18.

186. *Id.* at 17.

187. *See id.*

188. *See id.* at 17–18.

189. *Id.* at 18–19.

oriented, stable and cross-shareholding patterns among Japanese firms, however, would once again virtually shut down the market for corporate control in Japan.<sup>190</sup>

*Bull-Dog Sauce* was met with jeers by the foreign investment community, which viewed the ruling as confirmation that corporate Japan remains insular and unwelcoming to foreign investment.<sup>191</sup> Some domestic commentators, including the CVSG, also appeared to disapprove of at least the larger implications of the case. In June 2008, the CVSG issued a supplemental report taking stock of developments since the adoption of the Takeover Guidelines in 2005. With an understated but unmistakable tone of concern that the Takeover Guidelines had been (mis-)interpreted by management and even by the courts as approving any defensive step so long as shareholder approval were obtained, the 2008 report notes that “adopting defense measures in accordance with the Guidelines does not mean that their implementation is permitted unconditionally.”<sup>192</sup> The 2008 report discourages payoffs to bidders by target management of the kind made in the Bull-Dog Sauce contest. More pointedly, the CVSG opines, “[t]akeover defense measures that are . . . exploited for the purpose of managerial entrenchment should not be allowed . . . .”<sup>193</sup> Thus, a complex interplay emerged in Japan between rules developed by the judiciary and those developed by the subordinate lawmaker CVSG.

As the Bull-Dog Sauce controversy illustrates, Japan’s modest exposure to hostile takeovers in recent years has prompted a burst of institutional development. Without any significant legislative intervention,<sup>194</sup> Japan now has a complex, multilayered set of guideposts for hostile takeover defenses assembled by subordinate lawmakers, including the judiciary, unelected representatives of two agencies who steered a process of best-practice formation among market actors, and the TSE, a hybrid between a regulatory agency and a market actor.

190. See KIGYŌ KACHI KENKYŪ KAI [CORPORATE VALUE STUDY GROUP], DAI 23 KAI KIGYŌ GIJI YŌSHI [SUMMARY OF 23 MEETING] (2007), available at [http://www.meti.go.jp/policy/economic\\_industrial/gather/eig0000050/index23.html](http://www.meti.go.jp/policy/economic_industrial/gather/eig0000050/index23.html).

191. See, e.g., David Makman, *Japanese Market Reform Sputters*, 31 NAT’L L.J. at 13 (Sept. 1, 2008) (highlighting the *Bull-Dog Sauce* ruling in arguing that Japan permits “arbitrary or discriminatory” dilution of shareholders).

192. CVSG 2008 REPORT, *supra* note 181, at 6.

193. *Id.* at 3.

194. One exception: the tender offer rules were revised in 2006 to close loopholes in the mandatory tender offer rule for share purchases that cross the one-third level, and to impose a mandatory bid rule for share acquisitions that cross the two-thirds level. JAPANESE FINANCIAL SERVICES AGENCY, NEW LEGISLATIVE FRAMEWORK FOR INVESTOR PROTECTION 12–14 (2006) <http://www.fsa.go.jp/en/policy/fiel/20061010.pdf>.



### III. EXPLAINING THE DIFFERENCES

The discussion above underscores the pronounced differences among the institutional structures underlying the development and enforcement of takeover defense law in the United States, the United Kingdom, and Japan. The United States generally affords managers strong takeover defenses, to a limited extent through state takeover legislation but largely through state courts applying judge-made fiduciary principles. The U.K. Takeover Code, being essentially administrative and reliant on informal enforcement mechanisms, affords managers little or no discretion to utilize defensive measures and does not rely on court enforcement. In Japan, the takeover defense system is a still-evolving combination of administrative enforcement through the TSE and court enforcement through the application of the Takeover Guidelines and interpretation of the Company Law.

It is not intuitively obvious, however, why the regulation of takeover defenses in these countries came to differ so markedly. The diversion is particularly puzzling if one considers the similarities between the United States and the United Kingdom—both are highly industrialized, English-speaking, Anglo-Saxon Western democratic societies with sophisticated capital markets and relatively similar legal institutions of common law heritage. Although it is culturally Asian and its legal institutions draw on civil law traditions, Japan is also a modern, highly industrialized society with a representative government and sophisticated capital markets. Furthermore, in all three countries, the economic conditions that preceded the emergence of hostile takeovers of public companies were basically the same: shares of publicly traded companies became sufficiently dispersed, and attractively enough priced, to encourage investors unaffiliated with management to vie for control of some firms.

Why *did* the institutional structures within which takeover defense law was developed and enforced come to be so different in these three countries? For comparative legal and finance scholars, the answers are important. The analytical framework we developed in Part I provides a roadmap for finding these answers.

#### A. *Institutional Influences*

Common to all three countries is a low level of political and governmental interest in the subject of hostile takeovers—reflecting the low political salience of business law generally that we noted in Part I. Consequently, in all three countries, subordinate lawmakers supplied the legal innovations that responded to the emergence of hostile bids. However, the identity of the subordinate lawmakers in these countries varies significantly: Delaware courts in the United States, a private panel of experts in the United Kingdom, and a mixture of courts, agency-orchestrated experts, and the securities exchange in Japan. Different subordinate lawmakers responded to the rise of

hostile bids in these three countries due to major differences in the role of the judiciary in business disputes, and the role and influence of institutional investors in corporate governance issues. As a result, three highly developed capital markets have developed widely divergent substantive rules and enforcement mechanisms to regulate hostile takeovers.

1. *Limited legislative intervention and the identity of subordinate lawmakers*

Elected government officials—whether legislative or executive—played little or no role in determining the scope of permissible takeover defenses in any of the three countries. In the United Kingdom, the inauguration of the City Code and the Takeover Panel was accomplished without any action by Parliament; the Bank of England's gentle encouragement of private parties came closest to administrative action. In the United States, although Congress adopted the Williams Act in 1968 as a legislative response to abusive tender offers, it made no effort to regulate takeover *defenses* adopted by target company boards;<sup>195</sup> consequently, the SEC had no power to do so. The vacuum created by the absence of government intervention induced other U.S. actors to resolve the problems created by hostile takeovers. In Japan, two government agencies—METI and MOJ—did orchestrate the formulation of the Takeover Guidelines, but the entire process was informal and the ministries took up the issue precisely because legislation had failed to deliver clear solutions for the important new issues presented by the appearance of hostile takeovers.

The reason for the absence of formal involvement by elected government officials in these three countries is the low political salience of hostile takeovers.<sup>196</sup> Although the issue of takeovers attracted media and political attention in the United Kingdom at several points during the 1950s and 1960s, the British government expressed a clear desire not to legislate on the matter except as a last resort. In so doing, the government explicitly sought to preserve the flexibility to respond to changing market circumstances—flexibility that, it feared, would be destroyed by a statutory response.<sup>197</sup> Furthermore, a specific objective of the groups who stepped forward to produce the Takeover Code was to avoid Parliamentary intervention and regulation by an SEC-like administrative agency—a prime example of what we have called “preemptive” rulemaking by private actors in our analytical framework.

A similar explanation holds in the case of the United States, although the story is more complex. Abusive tender offers became sufficiently politically

195. That latter subject was addressed politically at the state level, however, in at least thirty-three states whose legislatures adopted anti-takeover statutes. This legislation, however, was designed to augment, rather than to restrict, target company boards' power to interpose hostile takeover defenses. IARTHUR FLEISCHER, JR. & ALEXANDER R. SUSSMAN, *TAKEOVER DEFENSE, MERGERS AND ACQUISITIONS* 4–24 (2010).

196. See CULPEPPER, *supra* note 1, at 1–8.

197. See *Back to the Jungle*, *supra* note 70, at 337.

salient in the 1950s and 1960s that Congress was impelled to pass the Williams Act. The driving political forces included the high-level management of U.S. public corporations, the discharged employees of acquired companies (and their labor unions) and, more generally, the local communities that were disrupted by takeovers. The Williams Act, by imposing structural requirements that eliminated tender offer abuses, was sufficient to alleviate the pressure on Congress to do more, such as adopting a federal regime to regulate takeover defenses. In this environment, the only elected government officials for whom takeover defenses remained politically salient were the legislatures of states that had experienced adverse hostile takeover effects, such as the elimination of target companies, facilities, and tax bases from the local communities where these companies had previously operated. Even state anti-takeover statutes, however, failed to regulate takeover defenses in any comprehensive way, and they preserved the regulatory vacuum that the state courts would soon come to fill.<sup>198</sup>

In Japan, hostile takeovers initially drew little political attention. Until at least the mid-1990s, Japanese companies were effectively insulated from hostile takeovers because they had stable shareholders in the form of commercial banks or members of the same corporate group. Although unsolicited bids for major stakes in publicly traded Japanese firms began to appear around the year 2000 as cross- and stable shareholding practices declined, it was not until the end of 2003 that METI mobilized to influence the development of rules stipulating the types of takeovers and defensive measures that should be deemed "reasonable."<sup>199</sup> According to one scholar, this delay occurred because most Japanese managers were previously indifferent to the threat of hostile takeovers. Until 1994, most hostile bids had been for small companies, not large firms whose managers acted through Keidanren, the most influential big business lobby in Japan.<sup>200</sup> Between 1993 and 2003, Keidanren's overriding concern was not hostile takeovers, but reforming corporate law both to enhance the ability of Japanese firms to compete internationally and to shield directors from liability for losses stemming from the economically disastrous decade of the 1990s.<sup>201</sup> Not until the UFJ/Sumitomo takeover battle in 2004, followed by Livedoor's attempted hostile takeover of Nippon Broadcasting in 2005, did it become clear that large public companies were also vulnerable to hostile takeovers. These developments made hostile takeovers a salient issue, not only for corporate Japan but also for METI, which maintains close links to industry and which dur-

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198. To reiterate, the federal courts had no role in this development, because the only legislation addressing hostile takeovers (including tender offers) was the Securities Exchange Act of 1934, which did not regulate the substantive legality of board-adopted defenses to hostile takeovers.

199. See CVSG 2005 REPORT, *supra* note 156, at 1–8.

200. See CULPEPPER, *supra* note 1, at 117–18.

201. *Id.*

ing the recession had reinterpreted its mandate to include corporate governance reform as a means of improving Japanese economic competitiveness.<sup>202</sup>

Although the Japanese Takeover Guidelines resulted from the same type of informal consultative process that characterized the United Kingdom's response in 1967 that produced the City Code and the Takeover Panel—a governmental agency convening private actors behind the scenes—the groups dominating these processes in the two countries were quite different. In the United Kingdom, as earlier noted, the primary constituencies represented in the process were institutional shareholders, investment bankers, and broker-dealers. In Japan, the represented groups included senior managers of non-financial firms formally organized through and represented by Keidanren,<sup>203</sup> securities industry professionals, and legal experts. Conspicuously absent from this informal body were representatives of institutional investors and labor.<sup>204</sup> In short, the subordinate lawmakers who initiated the formation of the Japanese takeover rules were sympathetic to management interests.

Not surprisingly, the principal result of the CVSG process was the adoption of the board-centric, management-oriented U.S. (Delaware) approach allowing board-adopted takeover defenses, and a rejection of the strict board neutrality approach required by the City Code. This result was also consistent with several important interests, both bureaucratic and professional, that happened to coincide with the interests of management.<sup>205</sup>

If hostile takeovers were a politically salient issue by the time that the CVSG was formed, why was this process carried out without elected government officials and the institutional investor community? In our view, this exclusion was possible because (1) the issue was treated largely as one of a technical, rather than political, nature (designing takeover rules that would be consistent with both corporate law norms in Japan and global standards on takeover defenses), (2) two administrative agencies preempted legislative action, thereby heading off involvement by elected officials, and (3) institutional investors were not represented in the CVSG.

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202. See *In the Shadow of Delaware?*, *supra* note 135, at 2211.

203. Keidanren, the primary management organization, is represented on the legislative council of the MOJ, which is the central administrative authority charged with reforming corporate law. Keidanren is also represented on deliberative councils formed by ministries interested in corporate and economic reform, including METI and the Financial Services Agency ("FSA"). Thus, management interests were fully represented in each prominent administrative forum where takeover policy could be vetted. CULPEPPER, *supra* note 1, at 124.

204. CVSG 2005 REPORT, *supra* note 156, at 3 (listing members of CVSG).

205. METI had a bureaucratic incentive to favor the Delaware approach because adopting the U.K. standard would have required a change in takeover bid rules, which fell under the jurisdiction of a different regulator, the FSA. For the elite Japanese corporate bar, many of whom had received graduate education in U.S. law schools, the Delaware approach was familiar and U.S.-style takeover defenses represented a potentially large new business opportunity. See *In the Shadow of Delaware?*, *supra* note 135, at 2206. As it has turned out, however, the form of poison pill defense adopted overwhelmingly by Japanese firms has not generated significant fee income for Japanese lawyers.

## 2. *The role of the judiciary as a subordinate lawmaker for business*

Only in the United States did the response to the rise of hostile takeovers fall entirely on the judiciary. Given the dramatically different roles of the judiciary in corporate law dispute resolution in the two countries, it is relatively easy to explain why the Delaware courts acted as a subordinate lawmaker in the United States, filling the vacuum created by legislative inaction, while the judiciary was completely uninvolved in the United Kingdom. The Japanese case is more complex, as we explain below.

In the United States, the state judiciaries have traditionally decided disputes involving corporate governance and corporate control. These matters have characteristically involved issues of corporate statutory or fundamental instrument (charter or by-law) construction, as well as the application of common law principles of fiduciary duty. These issues were traditionally regarded as matters of state law, to be resolved on a case-by-case basis by state courts, as distinguished from administrative agencies. As earlier noted, because of the absence of both federal interest in board-created takeover defenses and any tradition of state administrative regulation thereof, the state courts effectively became the primary takeover regulators by default. The U.S. Supreme Court decision in *Santa Fe Industries, Inc. v. Green*,<sup>206</sup> which held that the substantive fairness of fiduciary conduct was predominately a state law concern, increased the already-strong gravitational pull toward the state judiciary in this area of jurisprudence.

By way of contrast, the U.K. judiciary never played a similarly prominent role as adjudicator of corporate control and governance disputes in public companies.<sup>207</sup> This difference was due in great part to the different procedural rules that apply in the United Kingdom, including barriers to bringing class actions, the absence of a contingent fee system, and the “loser pays” attorneys’ fee rules.<sup>208</sup> These procedural rules discouraged private shareholders from bringing representative actions to enforce corporate and securities laws, a practice which had been commonplace for decades in the United States.<sup>209</sup>

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206. 430 U.S. 462, 478 (1977); *see also* *Business Roundtable v. U.S. Sec. & Exch. Comm’n*, 905 F.2d 406, 407 (D.C. Cir. 1990) (invalidating SEC Rule 19c-4, which imposed a “one share, one vote” requirement as a listing condition for NYSE- and Nasdaq-traded companies, because it exceeded the SEC’s authority under § 19(c) of the Securities Exchange Act of 1934, which was essentially limited to rules seeking to create a national market system, rather than rules regulating basic corporate governance).

207. John Armour et al., *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States*, 6 J. EMPIRICAL LEGAL STUD. 687, 690 (2009).

208. *Id.* at 692.

209. *Id.* The authors point out several important areas where the U.K. regulatory scheme affords more important protections than litigation, including the Takeover Panel process for “real time” takeover dispute resolution, the greater power of U.K. shareholders to vote on key issues and dismiss directors who do not perform up to expected standards, and the availability of schemes for obtaining advance clearance for fundamental corporate restructuring. *Id.* at 715–21. While these differences are undoubtedly important, they merely underscore the greater role played by litigation as a corporate dispute resolution mechanism in the United States than in the United Kingdom.

These differences in U.S. and U.K. civil procedure result in a much greater volume of litigation regarding corporate matters in the United States.<sup>210</sup> Consequently, Delaware courts have a greater capacity to opine on emerging issues than do their U.K. counterparts and their significant body of judge-made law is capable of being more responsive to changes in corporate affairs. In the context of takeover battles in the United Kingdom, numerous fights in the 1950s and early 1960s *might* have provided the opportunity for authoritative judicial guidance on appropriate managerial conduct. For example, the battle for the Savoy Hotel in 1953 saw the target management engage in an egregious example of a “crown jewels” asset lock-up, stopping the putative acquisition dead in its tracks. Rather than pursue the matter in the courts, however, the bidder chose to push for a governmental inquiry, which produced only non-binding guidance (albeit written by a leading company law litigator) on the duties of the target board.<sup>211</sup> Indeed, not until the late 1960s and early 1970s did the British judiciary issue their first precedents on takeover defenses,<sup>212</sup> by which time the issue had largely been rendered moot by the introduction of the Takeover Code.

As a subordinate lawmaker for hostile takeover rules, the Japanese judiciary lies midway between Delaware and the United Kingdom. The courts in Japan are neither the only actors adjudicating takeover disputes as in the United States, nor completely absent as in the United Kingdom. Rather, they share rulemaking and enforcement activity with other subordinate lawmakers, the CVSG and the TSE.

When hostile bids made their first appearance in Japan in the early 2000s, it was not obvious that the Japanese judiciary would come to play an important role in the enforcement of takeover defense rules. The post-war heyday of Japanese corporate governance was characterized by the “infrequency of direct resort to the standard legal mechanisms for resolving disputes and organizing relations among shareholders, managers, and creditors.”<sup>213</sup> To be sure, the courts were involved in a few cases involving defensive share issuances to white knights in the 1980s, and shareholder litigation was not as rare as in the United Kingdom (a very small number of cases in Japan, as opposed to none in the United Kingdom).<sup>214</sup> The courts,

210. *See id.* at 690–92.

211. *See* HOLLAND, *supra* note 52, at 3.

212. *See* Howard Smith Ltd. v. Ampol Petroleum Ltd., [1974] A.C. 82, 834–38 (P.C.); Bamford v. Bamford, [1970] Ch. 212, 242–43; Hogg v. Cramphorn Ltd., [1967] Ch. 254, 269.

213. Milhaupt, *supra* note 141, at 2104.

214. A key reason for the lack of shareholder suits is that, until the *Daiwa Bank* decision in the late 1990s, the Japanese courts had discouraged shareholder litigation against corporate managers by requiring the plaintiff to pay a sizeable security-for-costs bond. This shareholder-unfriendly landscape changed in 1993, however, with legislation fixing a modest filing fee for derivative suits. A true turning point came in the *Daiwa Bank* case, where a Japanese court held liable the directors of a Japanese bank for \$775 million in damages. *Id.* at 2115–16. This case led to a series of corporate governance reforms and to an increased role by Japanese courts in policing the conduct of Japanese fiduciaries, as evidenced (in part) by a large increase in the number of derivative suits subsequently filed in Japan. *See id.* at 2116. Even so, this change occurred only a short time before the hostile takeover movement gained momentum in

however, played nowhere near as central a role in Japanese corporate governance in the decades leading up to the 2000s as had those in the United States for more than a century. Thus, upon the appearance of a modest market for corporate control in Japan, it would have been safe to predict that takeover defenses and related disputes would be managed in a fashion much closer to that of the United Kingdom—in a relatively clubby atmosphere subject to administrative oversight and guidance. Such a prediction, however, would have been wrong.

Two factors, one apparently occurring by design and the other occurring by happenstance, tipped the balance toward a system in Japan more closely resembling the U.S. (Delaware) approach. First, the CVSG 2005 Report, which served as a precursor and intellectual foundation for the Takeover Guidelines, contained a sweeping endorsement of the Delaware standards for evaluating takeover defenses.<sup>215</sup> Although the report does not explicitly address the issue, an endorsement of Delaware standards would also appear to be (at least implicitly) an endorsement of the judiciary as the ultimate interpreter and enforcer of these standards in concrete disputes.

The second factor was the timing of the 2005 Livedoor episode, arguably the highest-profile corporate dispute in Japanese history, which happened to play out in the courts precisely when the CVSG and METI-MOJ processes were culminating.<sup>216</sup> The result was a symbiotic relationship between these processes and the judicial rulings in the *Livedoor* case. The draft CVSG 2005 Report and Takeover Guidelines were available to the court and quite clearly influenced its ruling, which one of us has described as a “*Unocal* rule with Japanese characteristics . . . .”<sup>217</sup> At the same time, a key portion of the *Livedoor* judicial ruling made its way into the Takeover Guidelines as finally adopted.<sup>218</sup> In short, both by design and by coincidence, the Japanese judiciary’s role as a key institutional player in takeover defenses became cemented in one fell swoop in the spring of 2005.

Importantly, however, although the Japanese courts are now centrally involved in takeover defense rules, they do not predominate as they do in the United States. As noted, the Japanese courts share the enforcement role with the TSE, whose listing rules have preempted a significant portion of the enforcement landscape by proscribing certain categories of defenses as a con-

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Japan, suggesting that even at that time court involvement in hostile takeovers was far from a foregone conclusion.

215. See *In the Shadow of Delaware?*, *supra* note 135, at 2196 (“The report is remarkable for its approval of Delaware takeover jurisprudence.”).

216. *Id.* at 2195–96.

217. *Id.* at 2210–11.

218. See JAPANESE TAKEOVER GUIDELINES, *supra* note 164, at 4 n.1, 4 cmt.4 (listing the various abusive takeover motives provided by the *Livedoor* High Court as the kind of takeover bids that would justify defensive measures).

dition for continued listing on the Nikkei.<sup>219</sup> This *ex ante* arrangement contrasts with both the U.S. institutional setup, where (state) courts decide the validity of takeover defenses on an *ex post*, case-by-case basis, and that of the United Kingdom, where courts play no role at all. The difference raises an important question: why did an institutional enforcement-sharing arrangement among subordinate lawmakers occur in Japan, but not in the United States or the United Kingdom? We defer our attempt to answer this question until we consider, in Part III.B, several factors that may account for the development of Japan's distinctive hostile takeover regime.

### 3. *The influence of institutional investors*

None of the factors identified thus far directly answer a key question posed by the divergence in the institutional structure for regulating takeover defenses in the two countries that experienced hostile takeover activity first—the United States and the United Kingdom. As between two jurisdictions so culturally and economically similar, why would one empower managers to defend against hostile takeovers and the other disempower—indeed preclude—corporate managers from that same activity? One might surmise that the interests of managers in both countries would be the same: to preserve, if not maximize, their autonomy.<sup>220</sup> Yet the United States and the United Kingdom respected these interests in opposite ways. The United States validates the interests of management by allowing target company boards, limited only by court-enforced fiduciary duty rules, to decide whether a tender offer may be presented to shareholders. The United Kingdom, by contrast, leaves that decision exclusively in the hands of the shareholders.

In our view, the factor that best explains the radical difference between these two jurisdictions is the influence of institutional investors on both the subordinate rulemakers for business law and on corporate governance issues generally. Although shareholdings in the United Kingdom are diffuse, U.K. corporate governance is significantly influenced by institutional investors, who are well equipped to represent the interests of shareholders as a class;<sup>221</sup> the interests of institutional shareholders corralled the institutions of corporate regulation for much of the latter part of the twentieth century. By contrast, institutional investors in the United States became active in corporate governance much more recently,<sup>222</sup> and their ability to influence the devel-

219. See KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW* 200 (2d ed. 2009) (citing TSE Listing Rules, Art. 417(8)e, which requires a third party to analyze whether a proposed merger is “fair” to shareholders).

220. See CULPEPPER, *supra* note 1, at 6 (emphasizing that autonomy is the primary criterion in establishing the political preferences for managers over regimes of corporate control).

221. See generally Armour & Skeel, *supra* note 10 (describing the differences between the U.K. self-regulation system, which has resulted in institutional investors being highly influential, and the U.S. system, which has primarily benefitted managers).

222. *Id.* at 1767–68.



opment of takeover law was limited by their greater geographical dispersion and the identity of the subordinate rulemakers to whom responsibility for regulating takeovers devolved.<sup>223</sup>

Institutions were emerging as the dominant class of investor in U.K. public companies when takeover battles first started to occur.<sup>224</sup> Particularly significant was the 1959 battle for British Aluminium, in which a group of significant pension funds and insurance companies met—quite possibly for the first time—to discuss their common interests and issue a joint statement emphasizing the importance of shareholder choice in takeovers.<sup>225</sup> The British Aluminium battle saw institutional investors flex their muscles in a way that hurt the investment banks that had sided with the incumbent boards—a lesson they internalized for the future.

In the immediate aftermath of the British Aluminium battle, the Bank of England established a working group to formulate rules of good conduct in relation to takeovers. This action was taken specifically to diffuse the public perception that there was a failure in the regulatory system regarding takeovers, and consequently to preempt calls for legislative intervention. Significantly, representatives of institutional investors and investment banks dominated the working group, with few management representatives and no employee representatives at all.

Thus, “one of the most important arbiters of corporate disputes in the UK—the Takeover Panel—developed largely in accordance with the wishes of institutional shareholders.”<sup>226</sup> Indeed, in the United Kingdom, “the traditional doctrinal pro-shareholder orientation of British corporate law was reinforced by the rise of institutional shareholding during the precise period that modern takeover regulation was being developed in the UK, i.e., in the 1960s, whereas this coincidence did not occur in the U.S.”<sup>227</sup>

In contrast to that of the United Kingdom, the U.S. corporate governance system relies heavily on state courts, which are not structurally dedicated, as a matter of priority, to protecting the interests of shareholders as a class. Indeed, as we argued in Part I, the judiciary is not generally responsive to lobbying or other forms of influence by any particular interest group. During the 1980s and early 1990s, the period when U.S. takeover defense doctrine was developed, institutional shareholders did not play an active role as litigants in court cases or as “activist” shareholders.

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223. *Id.* at 1776–81.

224. *See id.* at 1768–70. On the story of how they rose to prominence, see generally LESLIE HANNAH, *THE RISE OF THE CORPORATE ECONOMY: THE BRITISH EXPERIENCE* (1976) (attributing the emergence of institutional investors as a dominant class to the effects of the U.K. industry’s transformation into a structure of large, monopolistic firms); CHEFFINS, *supra* note 55 (explaining that tax rules immediately following World War II deterred ownership by individuals, favoring institutional shareholders instead).

225. *See No Early Move on Aluminium*, *supra* note 61.

226. KRAAKMAN ET AL., *supra* note 219, at 83; *see also* Armour & Skeel, *supra* note 10, at 1771–72.

227. KRAAKMAN ET AL., *supra* note 219, at 269 n.200.

As for activism, U.S. investors were significantly hampered by the very regulatory structure put in place during the 1930s to protect unsophisticated retail investors. At the level of individual firms, would-be U.S. activists were faced with the cost and complexity of satisfying the SEC's proxy rules.<sup>228</sup> Originally intended to maximize the transmission of information to retail investors, these rules increasingly came to deter activism by informed and sophisticated institutional shareholders. In contrast, their U.K. counterparts were able to influence boards through informal discussions precisely because the threat of removal via a proxy contest was very credible.<sup>229</sup>

The existence of the SEC, with the power to preempt stock exchange listing rules, made it more difficult for U.S. institutional investors than it was for their British counterparts to seize control of the lobbying agenda for general changes to the governance framework in the 1950s and 60s.<sup>230</sup> The SEC had interests and an agenda of its own. Having long viewed itself as the guardian of the interests of retail investors, the agency was hesitant to be seen as too cozy with Wall Street insiders. More prosaically, the requirements of administrative due process necessarily meant that its exercise of rulemaking power took a long time. To be sure, during the days of T. Boone Pickens the SEC was lobbied with proposals for U.K.-style prohibitions on two-tier bids. Had the SEC acted on these requests before the Delaware Supreme Court decided *Unocal* and *Moran*, the result of the disputed validity of the poison pill might perhaps have turned out rather differently. The SEC was still consulting on the matter, however, when the validations of the poison pill by the Delaware Courts checkmated the T. Boone Pickens-style structurally coercive bid.

In recent years, however, U.S. institutional shareholders, and especially hedge funds, have become increasingly (and successfully) assertive, both as litigants and as activists in these areas. Indeed, "[t]here has been . . . a perceptible shift in favor of shareholder interests over board autonomy . . ."<sup>231</sup> Initially this shift occurred without major changes in underlying law, as exemplified by institutional investor-sponsored shareholder resolutions that resulted in some public company boards voluntarily agreeing to either dismantle their poison pill defenses, adopt majority voting governance systems, or submit to a shareholder vote proposed charter amendments to de-stagger their companies' boards. Later, this activist institutional investor movement resulted in some legislative changes in the area of contested

228. ROE, *supra* note 6, at 104–05; See Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 526–29 (1990).

229. See Bonnie Buchanan et al., *Are Shareholder Proposals an Important Corporate Governance Device? Evidence from US and UK Shareholder Proposals*, 45–46 (last updated May 30, 2010) (unpublished manuscript) available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1572016](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1572016) (Eighty percent of U.K. shareholder proposals are concerned with removing or electing specific directors; only thirty percent of U.S. shareholder proposals relate to board issues, and none seek appointment of a particular director).

230. See Armour & Skeel, *supra* note 10, at 1776–78.

231. KRAAKMAN ET AL., *supra* note 219, at 83.

elections of directors. These changes are exemplified by recent amendments to the DGCL permitting corporations to adopt by-law provisions, not repealable by the board, requiring a majority vote to elect directors, and authorizing so-called “proxy access” and “proxy reimbursement.”<sup>232</sup> Even so, as of this writing the degree of institutional investor influence remains far greater in the United Kingdom than in the United States.

Compared to the situation in the United States, institutional investor activism in Japan is even more nascent and tepid. We earlier noted the institutional investor community’s absence from the process of formulating the CVSG 2005 Report and Takeover Guidelines. The simple explanation is the complete lack of a history of institutional shareholder activism in post-war Japan.<sup>233</sup> Shareholder activism in any form emerged only in the 2000s, and a majority of the handful of examples are associated in the public’s mind with jarring episodes involving aggressive foreign funds such as Steel Partners, or controversial domestic players such as Takafumi Horie of Livedoor infamy and Yoshiaki Murakami, head of Japan’s first buyout fund. The latter two players both ultimately received jail sentences for tactics that exceeded legal boundaries.<sup>234</sup> To the extent that domestic institutional investor activism of the CalPERS variety exists in Japan at all,<sup>235</sup> it has been conducted only since 2002 by a single organization known as the Pension Fund Association (“PFA”), which describes itself as a “reluctant activist.”<sup>236</sup>

By design, the Takeover Guidelines do not have the force of law, but were intended to generate consensus among market players. Thus, the critics of the outcome—particularly those left out of the process of formulating the CVSG 2005 Report and thus influencing the Guidelines—lacked any formal platform on which to contest it publicly. The Report was (unsurprisingly) not well received by the foreign institutional investor community. In fact, representatives of U.S. and U.K. investors urged the Japanese govern-

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232. DEL. CODE ANN. tit. 8, § 216 (2010) (authorizing by-laws specifying the vote, other than the default plurality vote, required to elect directors); § 112 (authorizing by-laws providing for shareholder access to management proxy materials in specified circumstances); § 113 (authorizing by-laws providing for proxy expense reimbursement). The first provision was adopted in 2007; the latter two were accomplished by amendments to the DGCL adopted in early 2009. *Id.* §§ 112–13, 216.

233. See Bruce E. Aronson, *A Japanese CalPERS or a New Model for Institutional Investor Activism? Japan’s Pension Fund Association and the Emergence of Shareholder Activism in Japan* 8 (2010) (unpublished manuscript) (available at [http://works.bepress.com/bruce\\_aronson/1/](http://works.bepress.com/bruce_aronson/1/)).

234. See Norimitsu Onishi, *Livedoor Tycoon Gets Jail Term for Fraud*, N.Y. TIMES, Mar. 16, 2007 (describing Horie’s sentence); *Murakami Gets Two Years in Jail in Livedoor Scandal*, N.Y. TIMES, July 19, 2007 (detailing Murakami’s sentence).

235. CalPERS is the largest public pension fund in the United States. It has an active corporate governance agenda. CalPERS, *CalPERS Investments*, CALPERS, <http://www.calpers.ca.gov/index.jsp?bc=/investments/home.xml> (last visited Nov. 6, 2010). It works with, and sometimes publicly criticizes, management of companies in which it has invested, and takes public positions on corporate governance issues. CalPERS, *Facts at a Glance: Corporate Governance*, CALPERS, 3–7 (Nov. 2010), <http://www.calpers.ca.gov/eip-docs/about/facts/corpgov.pdf>.

236. The PFA is an umbrella organization for corporate pension funds in Japan. For a thorough analysis of the PFA, see Aronson, *supra* note 233, at 36–38.

ment not to adopt it.<sup>237</sup> Because the entire process was informal, however, and because no elected officials were visibly involved in the formulation of the Guidelines, the only apparent path to creating a different set of rules would have been to lobby elected officials to enact legislation overriding the “soft law” that they provided. Thus, the domestic institutional investor community was left out of the process of formulating the Guidelines, and foreign investors were not well situated to promote a legislative end-run around the CVSG-METI-MOJ process.

This explanation, however, raises a different puzzle, relating to a unique feature of the Japanese takeover defense rules themselves that differs significantly from the counterpart rules in the United States and the United Kingdom. Although the CVSG 2005 Report recommended, and the Takeover Guidelines adopted, many of Delaware’s board-centric takeover defense concepts, there are important exceptions that are clearly shareholder-centric and, in this respect, much more akin to the United Kingdom’s City Takeover Code.

By way of example, the Guidelines endorse defensive action by target management, including rights plans, but emphasize that these plans must be reasonable and not unfair, proposing specific features that would satisfy these criteria.<sup>238</sup> These features include the following: (1) where possible, shareholders should approve the rights plan in advance, based on full disclosure of the plan’s purpose and its potential disadvantages;<sup>239</sup> (2) if the plan is adopted by board resolution, the plan should contain a mechanism enabling the board to remove it promptly and preserving the shareholders’ ability to replace the board at a single general meeting;<sup>240</sup> (3) there should be no unreasonably unequal treatment of shareholders other than the acquiring entity;<sup>241</sup> and (4) the terms of the rights plan should enable shareholders to respond to a tender offer based on their own exercise of judgment.<sup>242</sup>

This hybrid system of substantive rules, which includes elements of the U.S. and the U.K. approaches, raises the question of why, if the institutional investor community was missing from the process by which the Japanese rules were developed, these rules (and later interpretations thereof by Japanese courts) embodied some shareholder-centric elements.<sup>243</sup>

237. CULPEPPER, *supra* note 1, at 135–36.

238. See KRAAKMAN ET AL., *supra* note 219, at 242 (pointing out that “guidelines and court decisions anticipate that defensive action by target management will be lawful only where it enhances ‘corporate value’ and promotes the shareholders’ interests”).

239. JAPANESE TAKEOVER GUIDELINES, *supra* note 164, at 3. For a discussion of the Guidelines, see Jacobs, *supra* note 110, at 325–28.

240. JAPANESE TAKEOVER GUIDELINES, *supra* note 164, at 6, 9.

241. *Id.* at 11.

242. *Id.* at 13.

243. This puzzling feature of the Japanese corporate landscape is not unique to takeovers. Japanese boards remain largely dominated by inside directors and nominal outsiders affiliated with creditors or companies within the same group. Employee interests are typically far better represented on the board (and receive a higher priority in managerial decisionmaking) than investor interests. This leads to the

We defer a complete answer to that question, and to the question of why the enforcement structure is currently a hybrid between the U.S. and U.K. approaches, to the section that follows. At this point, we simply note that the PFA, Japan's "leading, and arguably . . . only, activist institutional investor,"<sup>244</sup> developed its own proxy voting guidelines for takeover defenses in April 2005, immediately in the wake of the Takeover Guidelines.<sup>245</sup> The PFA's guidelines provide that it will vote in favor of rights plans that meet criteria virtually identical to those enumerated in the Guidelines, namely: (1) sufficient explanation to shareholders of how the defense will enhance long-term shareholder value, (2) shareholder approval, (3) independent director approval or other clear criteria to prevent arbitrary decisions by management, and (4) limited duration.<sup>246</sup> From these similarities we conclude that the Guidelines' stance on defensive measures was acceptable to at least one important player in the institutional investment community, even though no institutional investor directly participated in the process of their formulation and institutional investors as a group were probably politically incapable of obtaining a legislative outcome favorable to their interests.

### *B. Japan's experience and possible lessons for emerging markets*

Before we turn our focus to emerging markets, it is useful to highlight the fact that Japan experienced virtually no hostile tender offers until about the year 2000—almost four decades after tender offers first surfaced in the United States and the United Kingdom, and long after the rules and institutions designed to address takeover defenses had developed and stabilized in these countries. As a late developer in terms of hostile takeovers and defenses, Japan's experience may be particularly relevant when considering the trajectories of institutional development and response in emerging markets. Thus, we consider here the role that "global" standards and stage of institutional development have played in the creation of Japan's hostile takeover regime.

To this point, the discussion has highlighted the unique, hybrid nature of Japan's approach to takeover defenses, as to both the substantive rules and the institutions involved in their interpretation and enforcement. The factors that are important in understanding the radical differences between the U.S. and the U.K. approaches partially, but do not completely, explain the features of the Japanese approach.

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question, "[h]ow can Japanese corporate law empower shareholders while its governance practice does not?" KRAAKMAN ET AL., *supra* note 219, at 85–86.

244. Aronson, *supra* note 233, at 8.

245. PENSION FUND ASSOCIATION, GUIDELINES FOR THE EXERCISE OF SHAREHOLDER VOTING RIGHTS ON ANTI-TAKEOVER MEASURES, 1–3 (Mar. 24, 2008), available at [http://www.pfa.or.jp/jigyo.shisan/gava\\_giketsuken/files/gov\\_e20080324.pdf](http://www.pfa.or.jp/jigyo.shisan/gava_giketsuken/files/gov_e20080324.pdf).

246. *Id.* at 1–2.

A full explanation requires consideration of the stage of Japan's institutional development at the time when hostile takeovers first appeared in Japan. The country was in the midst of a significant transformation in its economic and regulatory institutions. Additionally, two quite different "global" standards for takeover defenses—namely, the U.S. and the U.K. approaches—had already gained traction. These background conditions profoundly impacted the responses of rulemakers in Japan to this new form of transaction.

Many of the same forces that led to the emergence of hostile takeovers in Japan—most prominently the prolonged recession and globalization of domestic markets—also prompted deep institutional changes in Japanese corporate law, governance and economic regulation. Paralleling the CVSG process, in 2001 an expert panel established by the Prime Minister, the Justice System Reform Council recommended sweeping changes to Japan's legal system in an attempt to increase the rule of law in Japanese society.<sup>247</sup> A key passage of the Council's report states that the reforms seek "to transform the excessive advance-control/adjustment type society to an after-the-fact review/remedy type society" and to promote a "transformation in which the people will break out of viewing the government as the ruler . . . and instead will take heavy responsibility for governance themselves."<sup>248</sup> The overriding goals of the Council were the promotion of transparency, accountability, and public participation in governance. Japanese law reformers have devoted the years following the publication of the report to far-ranging attempts to increase legal formality and individual responsibility in economic relations, to promote free contracting and disclosure as the foundation of market transactions, and to move away from informal, often bureaucratically orchestrated mechanisms of economic governance.<sup>249</sup>

Japan's complex policy response to hostile takeovers is best understood in the context of this broader ongoing transition in the country's approach to law and governance. The CVSG had the difficult task of satisfying the simultaneous yet conflicting demands for, on the one hand, improved corporate governance (transparency, accountability, and free market contracting) and, on the other, the demands of vested market interests. Since Japanese society has still not resolved big-picture questions about whether or not it wants an "American" system of corporate governance and a full-throttle market orientation to its economy, it is not surprising that the CVSG and

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247. See JUSTICE SYSTEM REFORM COUNCIL, RECOMMENDATIONS OF THE JUSTICE SYSTEM REFORM COUNCIL: FOR A JUSTICE SYSTEM TO SUPPORT JAPAN IN THE 21ST CENTURY, ch. 2–4 (June 12, 2001), <http://www.kantei.go.jp/foreign/judiciary/2001/0612report.html>. Many of the reforms have now been enacted, such as changing the system of legal education, increasing the size of the bar, introducing a jury system in certain criminal trials, streamlining trial procedure, and enhancing transparency in the selection process for the judiciary. *Id.* ch. 2, pt. 2, ch. 3, pt. 5, ch. 4, pt. 1.

248. *Id.* ch. 1, pt. 1.

249. See *id.* ch. 1.

METI-MOJ process resulted in a politically deft, yet also ambiguous, mixture of old and new principles.<sup>250</sup>

In this context, the existence of two very different “global” standards for hostile takeover defenses might have *added* to the ambiguity of Japan’s response. At one level, the Delaware and U.K. approaches probably cabined purely protectionist impulses in forming the Japanese response. Both of these approaches, to varying degrees, provide opportunities for investors with different ideas about how their firms should be run to replace incumbent managers. Similarly, both approaches, again to varying degrees, promote the interests of shareholders over those of other corporate stakeholders. Thus, a response blatantly favoring incumbent management at the expense of investors, or providing government agencies with discretion to intervene in hostile bids, would have drawn condemnation as being out of step with the approaches taken by two highly developed countries that addressed the questions raised by hostile takeovers long before Japan. At the same time, however, the Japanese response reflects a dynamic that is prevalent around the world: the adaptation of “global” standards to suit the interests of domestic players with influence in the development of business law. Japan’s hybrid is not entirely recognizable as a pure incarnation of either the Delaware or the City Takeover Code model. Rather, it is a mixture of both that satisfies, at least roughly, the conflicting imperatives of the capital market and the interests of incumbents.

Because the Japanese takeover rules and related institutional structure are still evolving, the ultimate shape of the Japanese system is a story that has yet to be written. The only prediction we can venture is that its future contents will be determined based on how influential groups in Japan “make up their minds” about the big questions noted above, as well as on the regulatory competition that may ensue among subordinate rulemakers—the courts, TSE, and regulatory agencies—for the final word in interpreting and enforcing Japan’s takeover rules.

Every country’s institutional trajectory is, of course, unique, and it would be unwise to extrapolate extensively from Japan’s recent experience to predict developments in other countries, particularly ones with far shorter histories of corporate capitalism. Japan’s experience, however, does highlight two closely related points that are likely to be generically applicable to other nations. First, even in an increasingly global capital market, public ambivalence about the most sharp-elbowed elements of corporate capitalism strongly influences the evolution of national regulatory regimes for hostile takeovers. This is particularly the case because such ambivalence generally benefits incumbent interests in the economy that are threatened by a fluid market for corporate control. Second, while “global” standards provide at-

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250. See KRAAKMAN ET AL., *supra* note 219, at 273 (observing that “Japan is still making up its mind in this area”).

tractive and influential guideposts for national policymakers formulating hostile takeover rules, these standards are malleable, particularly when untethered from the idiosyncratic historical settings in which they developed. While the existence of global standards for hostile takeovers in the form of the U.S. and U.K. approaches probably helps constrain nakedly protectionist impulses in other countries, these standards are likely to be quietly adapted to suit the interests of dominant interests in the economy.

#### IV. IMPLICATIONS FOR EMERGING MARKETS

To this point in the Article, we have attempted to explain why three large, highly developed industrial economies with sophisticated capital markets have created substantially different rules and enforcement processes for hostile takeovers. We now seek to extend our analysis to emerging markets, specifically China, Brazil, and India. We have selected these countries for their economic and political significance, and because they seem poised, at some point in the not-too-distant future, to experience a level of unsolicited bids for publicly traded firms that could spark further development of their hostile takeover regimes. China, Brazil, and India are three of the four largest emerging market economies, ranked third, tenth, and twelfth in the world, respectively, in 2008 GDP.<sup>251</sup> Their mergers and acquisitions (“M&A”) activity, although still relatively low compared to that of the United States and the United Kingdom, has grown commensurately in recent years, as Figure 1 illustrates. Drawing upon our analytical framework and the U.S., U.K., and Japanese experiences, we explain key features of the current regulatory environments for hostile takeovers in these countries, and provide a roadmap for understanding the future evolution of the corporate takeover regimes in these countries.

##### A. *The existing rules and institutions*

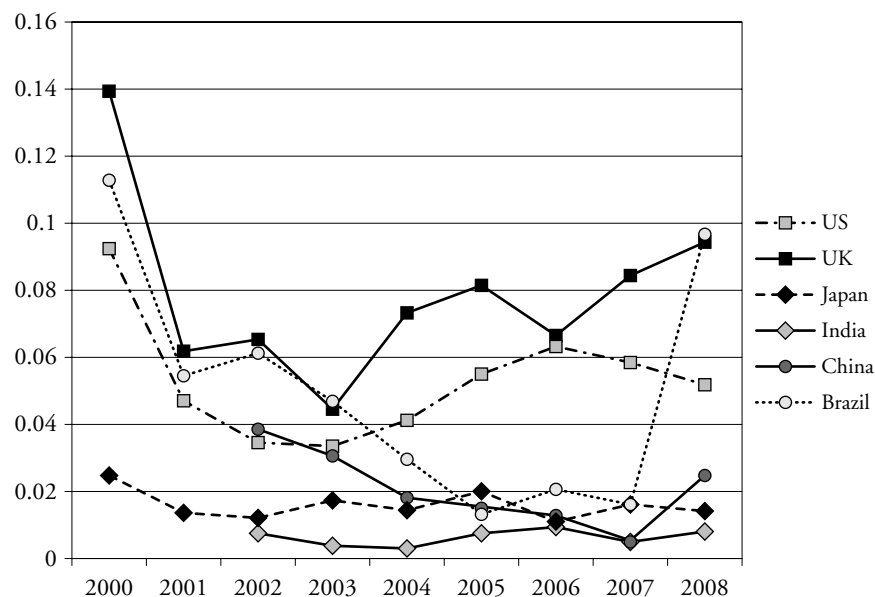
To date, these emerging markets have experienced very little hostile takeover activity. SDC Platinum, a well-known database of world M&A activity, lists only ten unsolicited transactions as ever having occurred in China, Brazil, or India, only one of which was successfully completed.<sup>252</sup> Although the details vary from country to country, the fundamental reason for this dearth of activity is common to all emerging markets: ownership of publicly traded firms is not sufficiently dispersed to permit the transfer of corporate control other than on a negotiated basis. This basic obstacle is often buttressed, as a matter of either policy or practice, by governmental restrictions on foreign

251. WORLD BANK, WORLD DEVELOPMENT INDICATORS: GDP (2009), available at <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD/countries/latest?display=default>. Russia, ranked eighth in the same tables, is the other of the four largest emerging markets. *Id.*

252. Thompson Reuters, *India Brazil China All Hostile Unsolicited*, (last accessed May 14, 2010) (SDC Platinum) [hereinafter SDC Database] (spreadsheet of results on file with authors).



FIGURE 1. M&amp;A ACTIVITY IN EMERGING AND DEVELOPED MARKETS



investment and by domestic institutional investors who support traditional business groups.

Despite the absence of market activity, the institutional landscape for hostile takeovers in the three emerging markets we examine is far from barren, as we sketch below.

### 1. *China*

State ownership of enterprise and regulatory requirements for major investments in Chinese firms creates an environment where there is little immediate prospect of a market for corporate control developing in China. The transformation of state-owned enterprises into publicly traded companies in the process of China's market opening has only been partial—indeed, the term used is *corporatization*, not privatization.<sup>253</sup> Organs of the central and provincial governments, or related affiliates, still control a majority of the shares of most companies listed on the Shanghai and Shenzhen stock exchanges.<sup>254</sup> Until recently, shares held by the state were not even legally

253. See MILHAUPT & PISTOR, *supra* note 12, at 130.

254. See Franklin Allen ET AL., *Law, Finance and Economic Growth in China*, 77 J. FIN. ECON. 57, 84–86 (2005); Lee Branstetter, *China's Financial Markets: An Overview*, in CHINA'S FINANCIAL TRANSITION AT A CROSSROADS 23, 52–56 (Charles Calomiris ed., 2007); Joseph P.H. Fan et al., *Politically Connected CEOs, Corporate Governance, and Post-IPO Performance of China's Newly Partially Privatized Firms*, 84 J. FIN. ECON. 330, 332–33 (2007).

tradable except to other state-affiliated investors.<sup>255</sup> In addition, the approvals of various government agencies, such as the Ministry of Commerce and the China Securities Regulatory Commission (“CSRC”, are required to complete a major investment in a Chinese listed company.<sup>256</sup> Ministry approvals, in turn, are predicated on board and shareholder approval of the transaction. Thus, without the cooperation of the state, an outside investor cannot gain control of a publicly traded Chinese firm.

Nevertheless, China has a highly developed takeover regime, at least as a formal matter. China’s approach, like that of Japan, is a blend of the U.K. and Delaware models, refracted through distinctive national institutions. The Securities Law (“China Securities Law”) and related rules of the CSRC contain a partial mandatory bid rule triggered by thirty percent share ownership.<sup>257</sup> Under the CSRC’s Takeover Rules (“CSRC Rules”), however, the agency can waive the mandatory bid rule for negotiated share acquisitions; it frequently uses this power.<sup>258</sup> This exemption is significant because negotiated share acquisitions are a common means of merging state-owned or state-affiliated enterprises in China, at the instruction of high-level government bodies such as the State Council (China’s cabinet) or the State-Owned Assets Supervision and Administration Commission (“SASAC”) (the state agency that acts as a holding company and monitor for the largest state-owned enterprises).<sup>259</sup> Moreover, since 2006, a mandatory bid need only be for a minimum of five percent of the outstanding shares, which greatly dilutes its effect.<sup>260</sup> These measures avoid the problem of mandatory bid rules stifling takeovers in countries where there are controlling shareholders by requiring control premia to be offered to minority shareholders as well.<sup>261</sup>

Consistent with the U.K. approach, the CSRC Rules permit target company boards to take post-bid defensive measures only if approved by shareholders.<sup>262</sup> At the same time, however, the CSRC Rules also contain

255. Hui Huang, *The New Takeover Regulation in China: Evolution and Enhancement*, 42 INT’L LAW. 153, 156–58 (2008).

256. Shangshi Gongsi Shougou Guanli Banfa (上市公司收购管理办法) [Measures for the Administration of the Takeover of Listed Companies] (promulgated by the China Sec. Regulatory Comm’n, Aug. 27, 2008, effective Sept. 1, 2006), art. 4 [hereinafter CSRC Rules], available at <http://www.lawinfochina.com/law/display.asp?ID=7043&DB=1>. An English translation is available at the same URL.

257. Zhonghua Renmin Gongheguo Zhengquan Fa (中华人民共和国证券法) [Securities Law of the People’s Republic of China], (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 29, 1998, effective July 1, 1999, amended Aug. 28, 2004 and Oct. 27, 2005), art. 88 [hereinafter China Securities Law], available at <http://www.csrc.gov.cn/n575458/n776436/n804965/n3300690/n3300780/3300919.html>; CSRC Rules, *supra* note 256, art. 24.

258. China Securities Law, *supra* note 257, art. 96; CSRC Rules, *supra* note 256, art. 47.

259. For information on the SASAC, see its official website, <http://www.sasac.gov.cn/n2963340/2964236.html>.

260. CSRC Rules, *supra* note 256, art. 25.

261. See Erik Berglöf & Mike Burkart, *European Takeover Regulation*, 18 ECON. POL’Y. 171, 196–98 (2003).

262. See CSRC Rules, *supra* note 256, art. 33. A small number of listed companies have amended their Articles of Association to insert defenses such as staggered boards or supermajority provisions. E-mail from Professor Li Guo, Peking University, to Curtis J. Milhaupt, Parker Professor of Comparative Corpo-

Delaware-like fiduciary standards that govern the adoption of defenses. They require target boards of directors to meet their “duties of loyalty and diligence to the company” and “treat all offerors fairly.”<sup>263</sup> They further specify that defensive measures “shall be beneficial to the interests of the company and its shareholders,” and that “directors shall not abuse their power to create obstacles to takeovers.”<sup>264</sup> While at first glance these rules may resemble a potentially unruly mix of the U.K. and Delaware approaches, it should be recalled that although U.K. directors are also subject to fiduciary duties regarding the adoption of takeover defenses, these duties are rarely enforced because compliance with the more exacting board neutrality standard necessarily subsumes compliance with the underlying fiduciary duties. Still, it is noteworthy that Chinese lawmakers have included explicit reference to fiduciary duties in the CSRC Rules.

As in Japan, China’s approach to enforcement is mixed. However, instead of a Japanese-style blend of *ex ante* stock exchange approval and *ex post* judicial review, China has engrafted a U.K.-style specialized panel model upon more traditional regulatory approaches featuring high levels of state control. In U.K. fashion, a specialized panel handles interpretive issues arising out of takeover transactions and considers revisions to takeover regulations. However, unlike the U.K. Takeover Panel, the Chinese panel is not an independent organ. Rather, it is under the jurisdiction of the CSRC.<sup>265</sup> The panel has only advisory authority, leaving the CSRC as the ultimate enforcement agent.<sup>266</sup> At this stage, it is not clear whether Chinese courts would accept cases involving contests for corporate control.<sup>267</sup>

## 2. India

India has to date experienced only a handful of unsolicited takeover attempts, all of which have failed.<sup>268</sup> The primary obstacle to hostile bids in India is the pervasive control of public firms by founding families.<sup>269</sup> Family

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rate Law and Fuyo Professor of Japanese Law at Columbia Law School (Apr. 1, 2010, 21:07 EST) (on file with authors).

263. CSRC Rules, *supra* note 256, art. 8; *see also* E-mail from Professor Li Guo, *supra* note 262.

264. CSRC Rules, *supra* note 256, art. 8.

265. Huang, *supra* note 255, at 173–74.

266. *See id.* at 173; *see also* CSRC Rules, *supra* note 256, art. 10 (calling on the CSRC to establish a special expert committee that will provide “consultancy opinions,” and stating that “*the CSRC shall make a decision according to law*”) (emphasis added).

267. In other areas of corporate and securities law, such as derivative suits and securities fraud litigation, many Chinese courts have been reluctant to accept suits without specific authorization from the Supreme People’s Court. Benjamin L. Liebman & Curtis J. Milhaupt, *Reputational Sanctions in China’s Securities Market*, 108 COLUM. L. REV. 929, 940–41 (2008). The Supreme People’s Court at one time specifically instructed lower courts not to hear certain types of securities cases. *Id.*

268. Cyril Shroff, *You Need a Defence Strategy*, 27 INT’L FIN. L. REV. 40, 40 (2008) (“The history of hostile acquisitions in India has been fraught with unsuccessful bids.”).

269. *See* Tarun Khanna & Krishna G. Palepu, *The Evolution of Concentrated Ownership in India*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 283, 283–89 (Randall Morck ed., 2005) (describing the persistence of concentrated family ownership of Indian corporations throughout the last century despite the market being governed by very different regimes over that time period).

ownership is buttressed by the attitudes of Indian financial institutions, which have historically been staunch supporters of controlling shareholders, valuing business and personal relations over financial returns based solely on share ownership.<sup>270</sup> These obstacles have been reinforced by a foreign investment regulatory regime that is highly protective of incumbent management.<sup>271</sup>

India's legal regime for hostile takeovers, like that of China, bears a superficial resemblance to the City Code.<sup>272</sup> India's Takeover Code ("India Takeover Code") was first introduced in 1997.<sup>273</sup> The India Takeover Code contains restrictions on the conduct of target managers once a bid has been launched<sup>274</sup> and an "open offer" (mandatory bid) rule requiring a general offer to be made by persons exceeding a specified control threshold, set since 1998 at fifteen percent, at a price no lower than the best price paid by the acquirer for the target's shares in the previous six months.<sup>275</sup> The Code is also promulgated and enforced by a specialist agency, the Securities Exchange Board of India ("SEBI").<sup>276</sup> Moreover, SEBI regulations generally prohibit issuance of warrants with an exercise price below a specified minimum linked to the recent trading price of the target company stock, thereby eliminating the possibility of adopting a U.S.-style poison pill at the pre-bid stage.<sup>277</sup>

Despite its ostensible similarity to the U.K. approach, the Indian Takeover Code is highly attuned to Indian shareholding structures, which, as noted, center on controlling shareholders, typically families (known under Indian corporate law as "promoters").<sup>278</sup> In contrast to the United King-

270. See generally Radhakrishnan Gopalan et al., *Affiliated Firms and Financial Support: Evidence from Indian Business Groups*, 86 J. FIN. ECON. 759 (2007) (describing the operation of internal capital markets in Indian businesses).

271. Until recently, a foreign acquisition that triggered an "open offer" under the SEBI Takeover Code had to be approved by the Foreign Investment Promotion Board of India, a process requiring a no-objection certificate from the target's board of directors. Even today, various required approvals by the Reserve Bank of India and the Foreign Investment Promotion Board leave an opening for protectionist sentiment to influence cross-border acquisitions of Indian firms.

272. While commonalities with the United Kingdom are greater in number than those with the United States, the Indian regime was not modelled overtly on that of the United Kingdom. The Bhagwati Committee, whose report prescribed the contours of the Indian regime, noted that its members had considered the takeover regimes of fourteen other countries. JUSTICE P.N. BHAGWATI COMMITTEE REPORT ON TAKEOVERS, Preface, para. 13 (1997), available at [http://www.takeovercode.com/committee\\_reports/pnb\\_preface.php](http://www.takeovercode.com/committee_reports/pnb_preface.php).

273. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, Gazette of India, section II(3)(ii) (Feb. 20, 1997) [hereinafter Indian Takeover Code], available at <http://www.sebi.gov.in/acts/taknotifi.html>. In the bill's amended, current version, 1997's section II(3)(ii) has been moved to section III(4).

274. *Id.* Rule 23(1).

275. *Id.* Rules 10, 20. In the original 1997 version of the bill, the trigger threshold was set at ten percent. *Id.* Rule 10 n.2.

276. See generally Armour & Lele, *supra* note 35 (describing the development of investor protection regulations in India).

277. Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000, ch.13.1.2 (Aug. 20, 2009), available at <http://www.sebi.gov.in/guide/sebidipguideaug09.pdf>.

278. Indian Takeover Code, *supra* note 273, Rule 2(1)(h).

dom's mandatory bid rule, acquirers that trigger an open offer requirement under the Indian Takeover Code need only offer to acquire an additional twenty percent,<sup>279</sup> as opposed to all, of the remaining shares. A full-blown mandatory bid rule can hinder control transactions where there are blockholders, as it requires bidders to offer the same premium to all minority shareholders as is offered to a blockholder.<sup>280</sup> Thus, like the Chinese rule, the Indian rule is a compromise that requires only a partial sharing of premia with minority shareholders.

At the same time, the Indian Takeover Code contains several channels through which blockholders in public firms may consolidate their holdings and successfully resist foreign takeovers. The principal mechanism for promoter protection is an exemption from the open offer requirement for "creeping acquisitions."<sup>281</sup> Under the Code, a shareholder that owns between fifteen percent and fifty-five percent of a company's shares may continue to acquire up to five percent of the company's stock each year without making an open offer.<sup>282</sup> Other exemptions from the open offer requirement provide similar ways for controlling families to strengthen their positions. One exemption that was removed from the Code in 2002 permitted preferential share allotments to promoters.<sup>283</sup> An exemption still exists for "inter se" transfers of shares among family members or group companies.<sup>284</sup> Observing this pattern, one commentator concluded that the ostensible similarity to the U.K. City Code was highly misleading: "Far from legitimising [sic] the contestability of control, India's takeover regulation has been the single most important enabling factor in the consolidation of promoter stakes against any possible takeover threat."<sup>285</sup>

### 3. Brazil

As in India, the chief obstacle to hostile bids in Brazil is the presence of a controlling shareholder, typically the founding family, in many Brazilian publicly traded firms.<sup>286</sup> Also, as in India, corporate law is highly protective of controlling shareholders. Indeed, a major policy goal of Brazilian corpo-

279. *Id.* Rule 21(1).

280. See Berglöf & Burkart, *supra* note 261, at 179.

281. Indian Takeover Code, *supra* note 273, Rule 11. The creeping acquisition has been the mechanism used by Tata group in protecting against hostile acquisition. Shaun J. Mathew, *Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities*, 2007 COLUM. BUS. L. REV. 800, 808 (2007).

282. Indian Takeover Code, *supra* note 273, Rule 11.

283. *Id.* Rule 3(1)(c), repealed by Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2002, Gazette of India, section II(3)(ii)3(a)(i) (Sept. 9, 2002).

284. *Id.* Rule 3(1)(e).

285. See Jairus Banaji, Thwarting the Market for Corporate Control: Takeover Regulation in India 4 (2005) (unpublished manuscript) available at <http://www.qeh.ox.ac.uk/dissemination/conference-papers/banaji.pdf>.

286. Erica Gorga, *Changing the Paradigm of Stock Ownership from Concentrated Towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries*, 29 NW. J. INT'L L. & BUS. 439, 445 (2009); cf. Karl V. Lins, *Equity Ownership and Firm Value in Emerging Markets*, 38 J. FIN. & QUANT. ANAL.

rate law has historically been to foster minority investment without jeopardizing founder control.<sup>287</sup> The Corporations Law of 1976 allowed up to two-thirds of a public company's outstanding shares to be non-voting.<sup>288</sup> A legislative reform in 2001 reduced the allowable maximum of non-voting stock to fifty percent, but firms that were already publicly traded as of that date were exempted from the more stringent regime.<sup>289</sup> A mandatory bid rule was instituted in the 2001 legal reform, but the rule only applies to voting stock, and the bid price may be as low as eighty percent of the price paid for the control block.<sup>290</sup> Brazilian corporate law contains no specific provisions on takeover defenses, but given the situation just described, there has been no particular need for defensive measures. Brazil has experienced almost no hostile takeover activity in its history.<sup>291</sup>

Developments over the past five years, however, have altered this institutional landscape. A new segment of the São Paulo Stock Exchange ("Novo Mercado," or New Market) was established in December 2000 to promote the growth of companies not tied to established corporate groups and to improve the corporate governance of public companies in Brazil.<sup>292</sup> The Novo Mercado has higher corporate governance standards than the traditional Exchange, including requirements that all shares be voting shares and that financial statements comply with either U.S. or International GAAP.<sup>293</sup> A wave of IPOs on the Novo Mercado in the mid-2000s created a meaningful number of publicly traded firms with more dispersed share ownership than the typical Brazilian public corporation, creating at least the potential for future hostile takeover activity.<sup>294</sup>

Many of the companies that went public on the Novo Mercado, as well as publicly traded firms on other sections of the Brazilian Stock Exchange without controlling shareholders, adopted anti-takeover measures in their by-laws. Known as the "Brazilian poison pill," these measures require a shareholder who reaches a specified threshold of share ownership (generally ten to thirty-five percent) to make a mandatory bid for all remaining shares

159, 166–67, 181 (2003) (investigating equity ownership in emerging markets and finding significant concentrated ownership and use of non-voting equity structures in much of Latin America).

287. See Bruno M. Salama & Viviane Muller Prado, *Legal Protection of Minority Shareholders of Listed Corporations in Brazil: Brief History, Legal Structure and Empirical Evidence*, 4 J. CIV. L. STUD. 2 (forthcoming 2010) (manuscript at 2).

288. *Id.* at 2–3.

289. *Id.* at 5.

290. *Id.* As in India, this compromise reflects the prevalence of controlling blockholder ownership structures in Brazil. In the presence of controlling blockholders, a mandatory bid rule serves to deter bids by requiring that any control premium paid to the blockholder be shared with the minority shareholders. A partial mandatory bid rule limits the extent of required sharing. See Berglöf & Burkart, *supra* note 261, at 196.

291. See Gorga, *supra* note 286, at 459 (describing a hostile bid in 2006 as "the first modern hostile takeover attempt in the Brazilian capital markets"). The SDC Platinum database identifies five "unsolicited" and no "hostile" transactions in Brazil. See SDC Database, *supra* note 252.

292. See Gorga, *supra* note 286, at 450.

293. *Id.* at 451.

294. See *id.* at 452–63; Salama & Prado, *supra* note 287, at 4.

at a specified price, typically a substantial premium over the current trading price of the target company's stock.<sup>295</sup> Shareholders who vote to remove the by-law provision are also required to make an offer to purchase all outstanding shares. In response to investor lobbying, the Brazilian securities regulatory authority Comissão de Valores Mobiliários ("CVM"), issued a policy statement ("Parecer Normativo" or Normative Rule) in 2009 indicating that it would not enforce this mandatory bid rule against shareholders voting to eliminate the by-law provision, on the grounds that the cost of potential entrenchment posed by such provisions would outweigh the benefits.<sup>296</sup> The policy statement is nonbinding, however, and the legal status of such by-law provisions is not entirely clear as of this writing.

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Even this brief sketch of the institutional arrangements for hostile takeovers in the three countries reveals some interesting patterns, viewed in terms of our analysis in the preceding parts of this Article. At first blush, the presence of highly developed rule structures for hostile takeovers in China and India, markets with little or no hostile takeover activity, may be surprising. But when viewed as a species of "preemptive" rulemaking, the existence, outward form, and substance of the rules become easier to understand. Although the overall scheme of these regimes ostensibly follows global "best practices" modeled on the U.K. Takeover Code, even a cursory review of the legal detail reveals systems closely tied to the interests of key players—the state in the case of China and controlling family shareholders in the case of India. China's framework permits the state (via the CSRC) to exempt major categories of transactions from the takeover regime, benefiting the state's interest in merging smaller firms to create larger, globally competitive national champions. The Indian regime patently protects the interests of promoters by allowing them to consolidate control.

Brazil's existing institutional environment is distinctive in several respects, but the underlying policy effect of protecting incumbent interests is no different. Brazil is unique in having a dual set of takeover protections to cover both the traditional and the new public firms in its capital market. The first, created through the legislative channel in the Corporations Law, protects controlling shareholders in Brazil's traditional system of corporate capitalism. The second is a set of rules for firms that formed outside the traditional structures and emerged entirely through private ordering by market actors. These private rules seek to preempt takeover regulation that may be developed in the future by legislatures or subordinate rulemakers. Although this private channel of rule development is reminiscent of the

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295. See Gorga, *supra* note 286, at 480; See also E-mail from Bruno Salama of Getulio Vargas, Professor of Law, Fundação Getúlio Vargas Law School, to Curtis J. Milhaupt, Parker Professor of Comparative Corporate Law and Fuyo Professor of Japanese Law at Columbia Law School (May 22, 2010, 12:27 EST) (on file with authors).

296. E-mail from Bruno Salama, *supra* note 295.

process that led to the U.K. City Code, the players involved, and thus the beneficiaries of the rules, are completely different.

Our analysis suggests that many countries around the world have arrived at a rough form of functional convergence on takeover rules, although by highly divergent paths. Outside the United Kingdom—the first country to devise rules for hostile takeovers, and this at a time when capital markets were exposed to far fewer global influences than they are today—all countries seem to be moving toward a set of rules and enforcement institutions that deter egregious mistreatment of shareholders by bidders and incumbent managers, yet still leave wide latitude for managers (and sometimes government agencies) to block bids that threaten their interests.

### *B. Pathways of Future Change*

Hostile takeovers of publicly traded firms in India, Brazil, and China are certainly conceivable, even though the timetable for this development will surely vary from country to country. Even in the near term, successful hostile bids for Indian firms are plausible. One analyst estimates that as of 2007, fifteen percent of India's public companies listed on the Bombay Stock Exchange 100, including some of its most prominent, have been susceptible to takeover.<sup>297</sup> One Indian corporate lawyer notes that “[a]s the Indian economic story evolves and M&A activity increases, hostile acquisition[s] cannot be far off.”<sup>298</sup>

The story is similar for Brazil, particularly given the emergence of a new class of firms with dispersed share ownership on the Novo Mercado. The possibility of a market for corporate control in China, however, is certainly more distant.<sup>299</sup> However, all shares of Chinese firms are now freely tradable as a legal matter, and as the Chinese economy and capital markets mature, the state may elect to relinquish control over some publicly traded firms or industrial sectors. One predictive indicator will be the extent to which the number of publicly traded firms without state investment increases over time.

The emergence of hostile bids in these countries, even in small numbers, would raise the political salience of the takeover regime and exert demand-

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297. Mathew, *supra* note 281, at 832–39.

298. Shroff, *supra* note 268, at 41.

299. In countries having a representative form of government—that is, all of the countries discussed thus far except China—these predictions can be made with far more confidence than in the case of China. Two characteristics significantly differentiate China from the others and arguably render it a *sui generis* case. First, its form of government is highly authoritarian. Second, China is currently the largest creditor nation in the world. The first distinguishing factor may make Chinese firms less vulnerable to capital market pressures exerted by foreign and other investors, since the state controls the extent to which corporate shareholdings of most publicly traded firms will (or will not) be dispersed. The second factor may to some degree alleviate concerns about attracting capital from foreign investors.



side pressure for legal reform.<sup>300</sup> As we observed in the case of Japan, channeling demand for reform of rules on hostile takeovers and defenses creates a major tension between, on the one hand, the need to follow global best practices and, on the other hand, the need to protect incumbent interests. This basic tension is evident in the rules promulgated thus far in China and India, which are modeled on the U.K. City Code yet contain safety valves for the protection of domestic incumbent interests.<sup>301</sup>

The existing rules governing hostile takeovers in all three emerging markets are consistent with the preferences of the dominant interest groups that ordinarily steer the direction of business law: established business groups, and, by extension in the case of China, the state. The question is whether an eventual increase in the political salience of hostile bids in China, India, and Brazil could change the preemptively established regulatory regime in favor of a more robust market for corporate control.

Our analytical framework suggests three possible pathways through which this development might occur. First, the political influence of domestic institutional investors might increase sufficiently to alter lobbying dynamics in takeover regulation, leading to the enactment of new legislation more favorable to investor interests. Second, the demand for takeover regulation might be channeled through the courts, which are institutionally less susceptible to influence by business incumbents. Third, the regulatory preferences of subordinate lawmakers in the form of securities regulators and stock exchanges might shift or diversify, leading to takeover rules or enforcement practices that favor investors.

The most direct, but in our view least likely, potential pathway for change in the takeover regimes of the emerging markets is legislation. Some increase in the political clout of institutional investors vis-à-vis established business groups in emerging markets would be a likely byproduct of the maturation of these countries' economies and capital markets. The diversification of ownership structures among publicly traded enterprises such as that taking place in Brazil suggests how the political calculus of business regulation might be altered through economic development. But as Japan's experience illustrates, institutional investor activism cannot be taken for granted even following major changes in a country's capital markets and corporate governance practices. Moreover, the obstacles faced by institutional investors in emerging markets will be magnified by the very existence of the preemptively developed regulatory regime: regulatory inertia will have to be overcome along with political pushback by incumbents. Because

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300. To be sure, in the case of China, the channels for this demand would be much less clear-cut than the democratic process in India and Brazil.

301. Indeed, the EU Takeover Directive, *supra* note 78, displays a similar tension: the Directive articulates a neutrality principle as a default rule, *id.* art. 9(2) at 19, but permits member states to enact legislation allowing shareholders to put in place, or authorize management to put in place, defensive measures, *id.* art. 12. Thus, an ostensible EU legislative nod to openness is circumscribed by more detailed rules at the national level.

at least a partial “solution” to the issues raised by takeovers already exists in these countries, the likelihood that a new approach will be legislated in the future seems low, even if the political salience of hostile takeovers increases.

As for the second possibility—that courts could become involved in resolving takeover-related disputes, thereby complicating or altering the existing regulatory framework—a stage-of-development perspective suggests that in the foreseeable future courts are unlikely to become major players in contests for corporate control in China, India, or Brazil. In elaborating broad fiduciary standards as a means of regulating hostile takeovers—even where, as in China, these standards are explicitly referenced in the takeover rules—the judiciaries of these countries would face significant obstacles. To begin, the U.K. model, which influenced the basic approach to hostile takeovers in all three countries, is inherently more regulatory than court-centered.<sup>302</sup> Shifting to a court-based approach would entail jumping off that fundamental regulatory track. Moreover, governments in many developing countries, particularly China, would hesitate to delegate lawmaking and enforcement power in a critical economic policy area to courts, which are difficult to monitor and control centrally. Lastly, even if a move to “judicialize” contests for corporate control were undertaken on the judiciary’s own initiative, it would inevitably raise concerns about institutional competence and efficiency. One major reason that the Delaware approach is unlikely to be replicated in pure form elsewhere—even in highly developed legal systems—is that it places extraordinary demands on the judiciary to respond, in real time and in full view of the capital markets, to legal issues deeply interwoven with complex business transactions where large sums of money are often at stake. Thus, notwithstanding the intellectual appeal of Delaware corporate law throughout the world,<sup>303</sup> court-enforced fiduciary standards are unlikely to play a significant role in the development of takeover policy in emerging markets.

This leaves a third—in our view the most likely—pathway of change: regulatory competition among subordinate lawmakers. Even if an increase in the political influence of domestic institutional investors is insufficient to alter a legislative outcome in a direct lobbying contest with business incumbents, maturation of the economy might shift the balance of regulatory power so that the regulatory “preferences”<sup>304</sup> of subordinate lawmakers no longer dictate outcomes that protect established patterns of corporate control. New subordinate lawmakers may seek to become involved in takeover regulation and enforcement, or the established policies of existing regulatory actors may come under challenge from within the regulatory agency. The

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302. Indeed, this fact may be one major reason that the U.K. approach was adopted.

303. See *In the Shadow of Delaware?*, *supra* note 135, at 2212–13. One commentator has recently suggested that the Delaware approach is suitable for India. See Mathew, *supra* note 281, at 843.

304. See *supra* text accompanying notes 18–20.

most likely actors in this competitive dynamic would be securities regulators and stock exchanges, such as the Novo Mercado and SEBI.<sup>305</sup>

As a matter of institutional competence and regulatory mandate, securities regulators and stock exchanges would predictably be more concerned with investor protection than with preserving existing patterns of corporate control in the national economy. Importantly, global competition for listings among stock exchanges provides strong incentives for exchanges to use their self-regulatory authority to protect investor interests.<sup>306</sup> This competition for listings could significantly constrain the race to the bottom in takeover regimes, just as it has influenced best practices around the world in other areas of corporate governance (for example, the role of independent directors).<sup>307</sup> In Brazil the securities regulator took a stand (albeit informally) against managerial entrenchment on the Novo Mercado. Institutional self-interest also helps to explain why the TSE quickly carved out an enforcement role for itself when hostile takeovers became politically salient enough to spark the development of a new Japanese takeover regime. Although the current impact of regulatory competition on the Japanese takeover regime is still uncertain, its potential to influence the trajectory of institutional development seems undeniable. In this respect, the Japanese case may be, if not a template, then at least highly instructive in predicting the future path of institutional evolution in emerging markets.

## V. CONCLUSION

As everyone from John Maynard Keynes to Yogi Berra is credited with saying, it is difficult to make predictions, especially about the future. We heed this admonition and hazard only one prediction here: the current institutions for hostile takeovers in China, India, and Brazil are unlikely to have reached the end stage of development, because in these countries market activity will raise the political salience of takeovers in the future.

As Japan's experience demonstrates, no significant capital market today is likely to remain insulated indefinitely from hostile takeover activity. Even long-prevailing shareholding patterns and cultural or political proclivities that discourage hostile bids can change—sometimes very abruptly. A similar pattern emerges from our examination of the United States and the United Kingdom: When share ownership becomes sufficiently dispersed and macroeconomic factors make acquisitions attractive, bidders for corporate control materialize. These bidders typically ignore prevailing social norms

305. Again, a caveat may be needed in the case of China. Regulatory competition at lower governmental and agency levels does exist in China. But it occurs only with the acquiescence of central governmental and party authorities. For a discussion of the devolution of regulatory authority in the Chinese context, see Liebman & Milhaupt, *supra* note 267, at 982.

306. See Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1453–64 (1997).

307. See, e.g., John C. Coffee, Jr., *Racing toward the Top: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1800–17 (2002).

about “proper” business behavior, instead structuring their bids to exploit vulnerabilities in the existing legal infrastructure. It seems only a matter of time before the pattern is repeated elsewhere, including in the major emerging markets.

Hostile takeovers in all markets emerge under a common set of circumstances, yet national responses to these new market developments diverge substantially. In this Article, we have attempted to provide a simple and universal framework for understanding why these responses differ so substantially. The framework explains regulatory differences in sophisticated capital markets such as those in the United States, the United Kingdom, and Japan, and provides insight into the current state and future trajectory of hostile takeover regulation in emerging markets that have yet to experience hostile bids in significant numbers.

