Is Moderation the Highest Virtue? A Comparative Study of a Middle Way of Control Transaction Regimes

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IS MODERATION THE HIGHEST VIRTUE?
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Yueh-Ping (Alex) Yang

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ABSTRACT

Comparative studies of control transaction regimes mostly compare between the Market Rule as adopted in the U.S. and the General Offer Rule ad adopted in European Union, while paying less attention to the Partial Offer Rule, a middle way model adopted in many East Asian countries such as Japan, South Korea, China, Taiwan, etc. In this paper, we attempt to fill this gap by highlighting the Partial Offer Rule adopted in these countries, analyzing this rule’s theoretical foundation and observing its implementation in practice. Our theoretical analyses of the Partial Offer Rule are comprised of two parts. First, by adding to the current economic analytical framework the factor of cost of funds, we demonstrate that, from the perspective of efficiency, the Partial Offer Rule dominates the General Offer Rule and is thus more representative of the mandatory bid camp. Second, by comparing these three regimes through the lens of their respective filter mechanism, we argue that the filter mechanism inbuilt in the Partial Offer Rule has its theoretical advantages in terms of incentivizing the target’s incumbent controlling shareholder to select an efficient acquirer, which, compared with the filter mechanisms inbuilt in the Market Rule and the General Offer Rule, is more effective. Having established the theoretical foundation of the Partial Offer Rule, we turn to observe the Partial Offer Rule in implementation. We identify several aspects in practice that may compromise the Partial Offer Rule’s theoretical advantages, ranging from various types of circumvention implemented by related market players to the defective design of events of exemption adopted by rule-makers. In sum, we provide comprehensive accounts both in theory and in practice of the Partial Offer Rule, a long neglected control transaction regime.

Keywords: mandatory bid; control transaction; tender offer; partial offer rule; general offer rule; market rule; control premium; controlling shareholder

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Confucius sighed, “Moderation should be the highest virtue!! But people have failed to embrace it for so long!!” ~ Moderation, Chapter 3

I. INTRODUCTION

One of the wisdom underlying Chinese traditions is the pursuit of “moderation,” that is, the exploration of a “middle way” of life style in order to achieve a balance in every aspect. In this paper, we will explore one “middle way” that is relatively less-noticed in comparative studies of corporate laws.

Corporate laws around the world are indeed converging, but “the end of the history” of comparative corporate laws has not yet arrived.1 Among the areas remaining divergent, one prominent topic is the regime of “control transaction,” that is, whether to and how to regulate a transaction between an acquirer and the target’s shareholders under which the acquirer aims to purchase the target’s shares to a controlling level. To date, mainstream comparative studies of the control transaction regimes mostly concentrate on the comparison between the “Market Rule” and the “General Offer Rule”.2 On the one end, the Market Rule, a relatively hands-off model which largely defers to the autonomy of the market of control and imposes minimal legal intervention, receives its popularity mainly in the U.S. Under this Rule, the acquirer is imposed very modest legal constraints other than disclosure. Specifically, when acquiring the target’s

1 For literatures raising the convergence observation in corporate laws, see generally Henry Hansmann & Reinier Kraakman, Reflections on The End of History for Corporate Law, in CONVERGENCE OF CORPORATE GOVERNANCE: PROMISE AND PROSPECTS 32 (Abdul Rasheed & Toru Yoshikawa eds., 2012); Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, in CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 33 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).
shares, the acquirer is under no obligation to initiate tender offer to the target’s public shareholders; whether to acquire all or part of the target’s shares as well as from which shareholder she purchases the shares are at the acquirer’s discretion. This rule’s merit basically rests on its minimum restraints of control transactions. On the other end, the General Offer Rule, an intensively-regulated model which is also referred to as the “mandatory bid rule”, is widely implemented in, among others, European Union countries. Under this Rule, if the amount of an acquirer’s purchase of the target’s shares reaches a controlling threshold (which is 30% of the target’s issued shares in many countries), after such purchase the acquirer is obliged to extend a tender offer to all shareholders of the target, offering to purchase all their shares; therefore, in the end the acquirer may be legally forced to purchase all the target’s shares notwithstanding its initial partial purchase plan. This rule’s merit basically rests on its more protection of the target’s minority shareholders and its prevention of the transfer of the target’s control to a looting acquirer. The battle between these two rules has lasted for decades, and it is still continuing on the two sides of the Atlantic Ocean.

What is less noticed is the third control transaction regime, a middle way which we term it the “Partial Offer Rule.” Countries currently adopting the Partial Offer Rule include Japan, South Korea, China, Taiwan, etc., which are significant economic powers as well. Under the Partial Offer Rule, if an acquirer plans to purchase the target’s controlling block of shares, she cannot conduct it privately; instead, she must initiate a tender offer procedure offering to purchase either all or part of their shares from all the target’s shareholders. Despite the obvious difference between the Partial Offer Rule and the General Offer Rule, many comparative studies tend to group these two rules together in a single concept of “mandatory bid rule” or “sharing rule” without making clear distinction. In fact, we find little argument, if any, having been made specifically for the Partial Offer Rule. On the other hand, in countries implementing the Partial Offer Rule, we find quite a number of associated critics; some of which even propose the abandonment of this Rule. Nevertheless, to the extent that the Partial Offer Rule appears a middle way that balances the facilitation of control transaction as advocated by the Market Rule and the protection of equal treatment of minority shareholders as advocated by the General Offer Rule, we believe this middle way model at least deserving some attention, and we wish to fill this gap.

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3 Throughout this paper, we prefer to term this regime as the General Offer Rule instead of the Mandatory Bid Rule for the convenience of comparing it with the Partial Offer Rule, the main theme of this paper.

4 Countries other than European Union countries that also adopt the General Offer Rule include Australia, Hong Kong, Singapore, Turkey, etc.

5 We will discuss this difference in infra Section II.A.a.

6 For earlier literatures making some case for the Partial Offer Rule, see generally Andrews, supra note 2 (although Andrews’ analysis focused on “sharing rule” which mixes the General Offer and Partial Offer Rule). For a more recent paper illustrating the rationale underlying the Partial Offer Rule as implemented in Canadian Ontario, see generally Edward M. Iacobucci, Why Does Ontario Require Equal Treatment in Sales of Corporate Control?, 58 U. TORONTO L.J. 123 (2008).

In this paper, we explore the Partial Offer Rule both in theory and in practice. On theoretical parts, we apply the analytical framework adopted by contemporary studies and inquire into the effect of the Partial Offer Rule on fostering/blocking efficient and inefficient transactions. While we demonstrate the high degree of resemblance of the Partial Offer Rule with the General Offer Rule, after adding the factor of cost of funds into the existing analytical framework, we prove the former’s superiority to the latter. Moreover, to push further the inquiry of the superiority of each regime, we also introduce a filter perspective which evaluates how each regime’s in-built “filter” mechanism functions in distinguishing efficient transactions from inefficient transactions and promoting the former. We argue that the Partial Offer Rule, compared with the Market Rule and the General Offer Rule, is equipped with a better-functioning filter which imposes the incumbent controlling shareholder’s some “skin in the play” and thus incentivizes the incumbent to select efficient transactions from inefficient ones. In contrast, we argue that the “filter” contained in the Market Rule (i.e. the fiduciary duty) and that in the General Offer Rule (i.e. minority shareholders’ inaction) relatively weak in reaching an as effective selection. We therefore argue that, to the extent that the target has an incumbent controlling shareholder, the Partial Offer Rule possesses some theoretical advantages. On practical aspects, on the other hand, we highlight several practical problems encountered with by those countries implementing the Partial Offer Rule. We introduce a number of transactional strategies adopted in the real world that would circumvent the Partial Offer Rule. We also conduct a comparative studies of the events of exemption implemented in different countries and highlight some controversial ones that would frustrate the spirit and purpose of the Partial Offer Rule. Overall, we find the Partial Offer Rule appealing in theory, but putting a theory in practice is always challenging.

This paper will be structured as follows: In Section II, we will describe in more detail the Partial Offer Rule, in particular its content, characteristics, implementation and variation in a number of East Asian countries. We will highlight the uniqueness of the Partial Offer Rule, especially its difference with the General Offer Rule, with the anticipation to presenting a clearer picture of this less-noticed regime. In Section III, we will assess the theoretical foundation of the Partial Offer Rule. We firstly clarify the benchmark to be used to evaluate different control transaction regime, in which we adopt an efficiency-centered lens and advocate that any form of protection of minority shareholders should be further assessed by its functional terms centering on whether a protection may increase the value of the firms and thus derivatively benefit all shareholders. Based on this established benchmark, we conduct economic analyses to demonstrate the resemblance of the Partial Offer Rule with the General Offer Rule, but we also expand the current analytical framework and prove the former’s superiority to the latter. We then analyze how the Partial Offer Rule, through its pro rata purchase rule, incentivizes the target’s incumbent controlling shareholder to select the acquirer in a more careful manner. We finally compare the filter mechanism contained in the Market Rule, General Offer Rule and Partial Offer Rule and derive our conclusion that the one under the Partial Offer Rule could be more effective in theory. Having established so, in Section IV we introduce how market players compromise the Partial Offer Rule by numerous ways of circumvention in practice. We refer to some ideas learned from the experience of the Partial Offer Rule camp and discuss several regulatory instruments needed for refining the Partial Offer Rule. In Section V, we provide the conclusion of this paper. Through the analyses of this paper, we wish to contribute to contemporary studies

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8 We will discuss the definition of “efficiency” as used in this paper in infra Section III.A.
of control transaction regimes by bringing the Partial Offer Rule under the spotlight. While we
do not intend to suggest the absolute superiority of the Partial Offer Rule to other regimes, we do
believe this very regime deserving more attention.

II. THE PARTIAL OFFER RULE: A MIDDLE WAY BURIED IN CONTEMPORARY DEBATES

To obtain control over a target company, an acquirer may either engage in a merger and
business/asset acquisition to consolidate the target’s business and/or asset into its own business, or
conduct a control transaction featured by share acquisition to obtain control over the target.
Although these two types of transaction are similar in functional terms, their nature differs: merger
and acquisition in essence are transactions between the acquirer and the target company, under
which the acquirer purchases the company or the company’s business or assets. This requires the
target’s corporate decision, in particular the board’s resolution and shareholders’ resolution. In
contrast, control transactions in essence are private transactions between the acquirer and the target
company’s shareholders, under which the acquirer purchases the shareholder’s asset, (i.e. their
shares). In ordinary cases, the target’s corporate decision is unrequired. This major difference
results in a separate legal regime for control transactions: for instance, unlike mergers and
acquisitions, control transactions typically neither require shareholders’ votes nor trigger appraisal
rights of dissenting shareholders for their exits.

Nevertheless, control transactions still alter the target’s controller and lead to fundamental
change of the target’s management and operational policy. These could significantly affect the
target’s value. If the target has already had a controlling shareholder in place, control transactions
also trigger coordination problems between the acquirer and the target’s non-controlling
shareholders and agency problems between the controlling and non-controlling shareholders.
These factors all warrant a reasonable inquiry into whether control transactions call for some form
of regulatory controls. As mentioned above, contemporary literatures on comparative studies
have devoted considerable attention to two main regimes for control transactions, i.e. the Market
Rule and the General Offer Rule. To supplement them, in this paper we will instead focus on the
third model that is equally prevalent in the world: the Partial Offer Rule.

A. The Partial Offer Rule in the Landscape of Comparative Corporate Law

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9 Davies & Hopt, supra note 2, at 225-26.
10 We, however, do note that, in some jurisdictions, dissenting shareholders’ appraisal right is acknowledged in the
case of control transaction, and some commentators do propose it. In the U.S., the Pennsylvania State, the Maine State
and the Utah State all provide similar “control share cash-out statutes.” For instance, according to Section 2546 of the
Pennsylvania Business Corporation Law, “After the occurrence of the control transaction, any holder of voting shares
of the registered corporation may, prior to or within a reasonable time after the notice required by section 2545 (relating
to notice to shareholders) is given, which time period may be specified in the notice, make written demand on the
controlling person or group for payment of the amount provided in subsection (c) with respect to the voting shares of
the corporation held by the shareholder, and the controlling person or group shall be required to pay that amount to
the shareholder pursuant to the procedures specified in section 2547 (relating to valuation procedures).” Due to the
limited paragraph, however, in our following analysis we will temporarily set aside these discussions. For some
introduction of the minority shareholders’ appraisal right in acquisition of control, see generally Stephen Kenyon-
Slade, MERGERS AND TAKEOVERS IN THE US AND UK – LAW AND PRACTICES 186-87 (2004); Bebchuk, supra note 2,
at 982-83.
11 Davies & Hopt, supra note 2, at 229.
a. Overview of the Partial Offer Rule

The Partial Offer Rule contains two main elements: mandatory bid requirement and pro rata purchase. In terms of the mandatory bid element, under the Partial Offer Rule, an acquirer who plans to acquire the target’s control are legally required to conduct her plan through public tender offer procedures. This means that this acquirer is forbidden from purchasing shares from specific shareholder(s) in a private setting. Instead, she must make a public offer to all shareholders to purchase, at a fixed stated price, shares that are tendered during a stated period of time. For instance, assuming that A has no shareholding of Company B and plans to acquire 60% of Company B’s issued shares, which has reached the controlling level. Assuming further that C is Company B’s current controlling shareholder and holds 60% of the Company B’s issued shares. In such case, A cannot purchase the control over Company B by simply purchasing 60% shares from C. To realize her acquisition plan, A must do it through a tender offer procedure under which she makes public offer to Company B’s all shareholders.

In terms of the pro rata purchase element, under the Partial Offer Rule, an acquirer may opt for a partial bid, meaning that she is permitted to make a public offer to purchase only part of the target company’s shares. In cases where the amount of the shares tendered from the target’s shareholders exceeds that the acquirer plans to purchase, the acquirer is under no obligation to purchase all the tendered shares. Rather, the acquirer may purchase shares from all the shareholders tendering their offer on a pro rata basis, determined by the planned acquisition amount divided by the total tendered amount then multiplying each shareholder’s tendered amount. For instance, following the example in the preceding paragraph, assuming that A has made tender offer to Company B’s all shareholders, while 80% of Company B’s shares tender their shares, A does not need to purchase all these 80% tendered shares. Instead, she can stick to her purchase plan and purchase only 60% of Company B’s shares. In such case, all tendering shareholders may only sell 75% of their tendered shares, which figure is come up with by having the planned acquisition amount (i.e. 60%) divided by the tendered amount (i.e. 80%). To further illustrate the pro rata purchase rule by another instance, if maintaining all the above assumption, except that now A has already held 10% of Company B’s shares and intends to purchase another 50% to make its holding 60%, under the Partial Offer Rule A still has to initiate a tender offer, but in such case the tendering shareholders only get to sell 62.5% of their tendered shares (as come up with by having the planned acquisition amount of 50% divided by the total tendered amount of 80%).

While the Partial Offer Rule is similar to the General Offer Rule to the extent that acquirers are similarly obliged to initiate a tender offer procedure, it contains two major differences. First, the acquirer may opt for a partial offer. Under the General Offer Rule, the acquirer is legally required to purchase whatever amount of shares tendered by the target company’s shareholders. This obligation does not exist under the Partial Offer Rule. Under the Partial Offer Rule, the acquirer needs not purchase the shares exceeding the amount that she plans to acquire; in the event that the tendered amount exceeds the targeted amount, the pro rata purchase rule as described above applies. Therefore, the acquirer obtains more room under the Partial Offer Rule. Second, unlike the two-phase, ex post acquisition process under the General Offer Rule, the mandatory tender offer procedure under the Partial Offer Rule is one-phase and ex ante. To illustrate it,
under the General Offer Rule, an acquirer can purchase the planned amount of shares through private transaction in the first phase and subsequently initiate a tender offer to purchase remaining shares in the second phase. In this setting, the mandatory tender offer is an *ex post* procedure in the sense that it is initiated *after* the acquirer obtains the target’s control. In contrast, under the Partial Offer Rule, once the acquirer “plans” to purchase the target’s shares above the controlling threshold, any private transaction is prohibited. Instead, the acquirer must implement her plan through a single tender offer procedure, and the mandatory tender offer is an *ex ante* procedure in the sense that it is initiated *before* the acquirer obtains the control.

**b. The Partial Offer Rule Camp: Japan, South Korea, China and Taiwan**

While the Partial Offer Rule is less noticed in current comparative studies, in the real world a number of countries do implement it as their control transaction regimes. Here we select four major countries maintaining the Partial Offer Rule: Japan, South Korea, China and Taiwan, each representing different path of evolution.13

_i. Japan: A Pioneer Which is Having Shaky Faith_

Among the Partial Offer Rule camp, perhaps Japan can be considered one of the leaders.14 Initially, Japan adopted the Market Rule similar to the U.S. system, under which no mandatory bid rule was provided for. In 1990, however, Japan introduced the Partial Offer Rule into the amended Japanese Securities Exchange Act, which stipulates that if an acquirer intends to obtain more than one third of the target’s shares, she is obliged to make the acquisition by means of tender offer although the acquirer is free to determine the amount of shares that she wishes to purchase.15 This reflects the spirit of the Partial Offer Rule.

In 2006, however, a major amendment took place. The title of the law was changed from the original Securities Exchange Act to the current Financial Instruments and Exchange Act. After this amendment, the Partial Offer Rule is still maintained in the new Act,16 but the new Act also adds a new provision which stipulates that an acquirer shall purchase all shares that are tendered if she obtains more than two thirds of the total voting shares of the target company.17 This essentially introduced a second layer of mandatory bid rule on top of the original Partial Offer Rule, which is in essence a General Offer Rule. The purpose of this amendment was said to guarantee the opportunity of minority shareholders to exit from the target company, which is similar to the rationale underlying the General Offer Rule as implemented in European Union members.18

After this amendment, Japan currently maintains a mixed and two-track regime embodying

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13 To be sure, while the examples we enumerate here are all East Asian countries, we are not making a geography-based argument that the Partial Offer Rule is a feature of East Asian corporate laws. Many East Asian countries adopt the General Offer Rule instead of the Partial Offer Rule, such as Hong Kong and Singapore, etc. There are also jurisdictions outside East Asia that adopt the Partial Offer Rule, for instance, Canadian Ontario (for an introduction of the mandatory bid rule in Ontario, see generally Iacobucci, supra note 6). Here we only wish to point out that there remains a big world outside the U.S. and EU.

14 For an English introduction of the Partial Offer Rule in Japan, see generally Fujita, supra note 7.

15 Securities Exchange Act art. 27-2(1) (Japan).

16 Financial Instruments and Exchange Act art. 27-2(1) (Japan).

17 Financial Instruments and Exchange Act art. 27-14(4) (Japan).

18 Fujita, supra note 7, at 33.
both the Partial Offer Rule and General Offer Rule. If an acquirer plans to hold more than one third of the target’s shares, the Partial Offer Rule applies; when her holding exceeds two thirds of the target’s issued shares, the General Offer Rule applies.\(^\text{19}\)

\[\text{ii. South Korea: A Forerunner Which was Forced to Retreat}\]

South Korea is another forerunner in the Partial Offer Rule camp, but its control transaction regime experienced significant challenges during the Asian Financial Crisis. Before the Asian Financial Crisis, South Korea maintained a Partial Offer Rule known as the “50 percent plus one share” rule, under which any acquirers who wished to hold 25% or more of the target’s shares must acquire them through public tender offer and offer to purchase more than 50% of the target’s shares. Since this rule in effect forced potential acquirers to purchase 50 percent plus one share of the target, which was a significant burden, it effectively protected incumbent controlling shareholders. Moreover, during the Asian Financial Crisis in late 1990s, due to this rule foreign investors were also blocked from acquiring financially distressed Korean firms.\(^\text{20}\) Consequently, under the pressure of the International Monetary Fund,\(^\text{21}\) the amended Korean Securities and Exchange Act of 1998 finally abolished this rule, which was considered South Korea’s one big progress in attracting foreign investment.\(^\text{22}\)

Even though the 50 percent plus one rule was removed due to the Asian Financial Crisis, South Korea preserved a variant set of Partial Offer Rule in its current laws.\(^\text{23}\) Under the current Financial Investment Business and Capital Markets Act, which largely incorporates the rules of the old Korean Securities and Exchange Act,\(^\text{24}\) if an acquirer intends to purchase the target’s shares outside the securities market from ten or more persons within a six month period, and as a result her aggregate shareholding ratio reaches or exceeds 5%, she must initiate a public tender offer to do so.\(^\text{25}\) The same obligation also applies to an acquirer that already holds 5% or more shares

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\(^{19}\) There is in fact a third layer in Japan providing for a 5% rule, that is, if an acquirer plans to purchase more than 5% of the target’s shares, it shall initiate a tender offer procedure to implement its plan. However, this 5% rule is not applicable when the acquirer buys the shares from less than 10 shareholders within 60 days, which is a big exception for the acquirer and renders this 5% layer less applied.


\(^{23}\) For a brief introduction of the partial offer rule implemented in South Korea after the Asian Financial Crisis, see Kwang-Rok Kim, *The Tender Offer in Korea: An Analytic Comparison between Korea and the United States*, 10 PAC. RIM L. & POL’Y J. 497, 503-04 (2001).


\(^{25}\) Financial Investment Business and Capital Markets Act art. 133.3 (S. Kor.), Enforcement Decree of the Financial Investment Services and Capital Markets Act arts. 140.1 & 140.2 (S. Kor.).
and intends to purchase additional shares from ten or more persons within a 6 month period. The pro rata purchase rule is also well confirmed: an acquirer may choose to include in its public notice of tender offer and the tender offer registration a condition that if the total number of tendered shares exceeds the proposed number of shares for the tender offer, she will buy the stocks pro rata within the limit of the proposed number of shares for tender offer and will not purchase all or part of the excess shares. This 5% threshold rule becomes the remnant of the Partial Offer Rule in South Korea.

iii. China: A Latecomer Which Switched from Another Camp

China is another prominent example. Initially, it adopted the General Offer Rule: pursuant to Article 81 of the 1999 Chinese Securities Law and Articles 13 and 23(2) of the 2002 Measures for the Administration of the Takeover of Listed Companies (the “Takeover Measure”), an acquirer is required to extend the offer to all the target’s shareholders to purchase all of their shares if she holds 30% of a listed company’s issued shares and continues to acquire shares. However, when China amended its Securities Exchange Law and the Takeover Measure in 2006, it abandoned the General Offer Rule and turned to the camp of the Partial Offer Rule; the claimed purpose was to “decrease the acquisition cost, reduce the acquirer’s motive to circumvent the rules, avoid complicated approval procedure and foster the acquisition of listed companies.”

Currently, under Chinese laws, if an investor holds 30% of the shares of a listed company through trade in securities on the stock exchange and continues to acquire shares, she shall extend an offer to all of that listed company’s shareholders to purchase all or part of their shares. Similarly, if an acquirer has already held 30% or more of a listed company’s issued shares through private acquisition agreement and continues to proceed with acquisition, she must extend a tender offer to that listed company’s all shareholders to purchase all or part of their shares, unless the State Council’s securities regulatory authority exempts such offer. The Takeover Measure also restates the above provisions in similar language. The pro rata purchase rule is also well-confirmed: for acquirers who extend partial offer, she shall purchase the shares tendered by the target’s shareholders in accordance with the conditions set forth in the takeover offer; if the amount of tendered shares exceeds the planned acquisition amount, the acquirer shall purchase the tendered shares on a pro rata basis. These provisions all embody the Partial Offer Rule.

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26 Financial Investment Business and Capital Markets Act art. 133.3 (S. Kor.).
27 Financial Investment Business and Capital Markets Act art. 141.1.2 (S. Kor.).
28 For English introduction of the Partial Offer Rule in China, see generally CHEN, supra note 7; Weng, supra note 7; Cai, supra note 7; Huang, supra note 7.
29 The Memorandum for Revising the “Takeover Measure” I.1 (China).
30 Securities Law art. 88 (China).
31 Securities Law art. 96 (China).
32 Measures for the Administration of the Takeover of Listed Companies [Takeover Measure] art. 24 (China) provides that if through the trade in securities in the securities exchange an acquirer’s holding of a listed company’s shares has reached 30% and continues to increase its holding, the increase in holding shall be implemented by offer in the form of either general offer or partial offer. Article 47, Paragraph 2 of the Takeover Measure provides that if an acquirer’s holding of a company’s issued shares has reached 30% and continues to proceed with the takeover, it shall issue general or partial offer to that listed company’s shareholders in accordance with laws, provided that the acquirer may apply from the Chinese Securities Regulatory Commission for exemption from offer.
33 Takeover Measure art. 43 (China).
iv. Taiwan: A Variant Which Implements Unorthodox Threshold

Taiwan also adopted the Partial Offer Rule since 2002. Under current Taiwanese laws, if any person independently or jointly with another person(s) proposes to acquire a certain percentage of the total issued shares of a public company, she shall make the acquisition by means of a public tender offer. This percentage, in turn, refers to cases where an acquirer who, individually or jointly with another person(s), intends to acquire within 50 days shares accounting for 20 percent or more of the total issued shares of a public company. The pro rata purchase rule is also well-confirmed under Taiwanese laws: “if the shares number to be sold has exceeded the projected shares number to be acquired, the offeror shall purchase the shares pro rata from all the tenderers.” These provisions altogether stipulate the mandatory bid and the pro rata purchase elements of the Partial Offer Rule.

What makes Taiwan’s rules different with the typical Partial Offer Rule is: in Taiwan, only when the acquirer plans to purchase 20% of the shares within 50 days will the obligation to initiate tender offer be triggered. Hence, the threshold triggering the mandatory tender offer is unrelated to how much shares the acquirer will hold “after” the transaction, but how much shares the acquirer purchases “in” the transaction as well as how frequent the acquirer engages in acquisition. In other words, the threshold is less about a controlling threshold than a transaction amount threshold. An acquirer can purchase as many shares as she wishes without triggering the mandatory bid rule as long as she purchases them through separate transactions with adequate intervals between each transaction. This makes Taiwanese Partial Offer Rule an unorthodox one. Having said so, to the extent that there is a pro rata purchase rule and the tender offer procedure is one-phase and ex ante, Taiwanese control transaction regime still follows the basic line of the Partial Offer Rule.

B. A Middle Way Missed in the U.S.-EU Dichotomized Debate

Despite the Partial Offer Rule’s presence in many influential economic powers in the world, it does not attract as much attention as that to the Market Rule and the General Offer Rule. Such less notice could be partly due to that the two most influential economic powers, i.e. U.S. and EU, adopt distinct regimes that occupy the two extremes of the spectrum and take up most of the spotlight.

a. Dichotomized Debate between the U.S. and EU Models

In this part, we briefly introduce the Market Rule in the U.S. and the General Offer Rule in EU for presenting contrasts with the Partial Offer Rule.

i. The Market Rule in the U.S.

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35 Securities Exchange Act art. 43-1(3) (Taiwan).
36 Regulations Governing Public Tender Offers for Securities of Public Companies [Tender Offer Regulation] art. 11(1) (Taiwan).
37 Tender Offer Regulation art. 23(1) (Taiwan).
38 For papers comparing the U.S. model and EU model, see e.g., Elhauge, supra note 2; Magnuson, supra note 2; Davis & Hopt, supra note 2.
The U.S. implements the Market Rule and place minimal limitation on control transactions.\textsuperscript{39} Despite some court cases imposing obligation on controlling shareholders to compensate remaining shareholders for foreseeable harms caused by the sale or to share the premium with non-controlling shareholders,\textsuperscript{40} the U.S. courts in general have not adopted a general principle mandating the equal sharing of control premium between controlling and non-controlling shareholders.\textsuperscript{41} Section 5.16 of the American Law Institute (“ALI”) Principles of Corporate Governance summarizes well the current control transaction regime in the U.S., “a controlling shareholder has the same right to dispose of voting equity securities as any other shareholder, including the right to dispose of those securities for a price that is not made proportionally available to other shareholders.”\textsuperscript{42}

This does not mean that control transactions are subject to no regulatory controls in the U.S., though. Two major valves govern control transactions in the U.S. The first valve is the disclosure requirements provided under related securities laws. Since the 1968 Williams Act, an acquirer who plans to acquire the target’s beneficial ownership to more than 5% must, within 10 days after the acquisition, file with the U.S. Securities and Exchange Commission (“SEC”) the Schedule 13D for disclosing required information.\textsuperscript{43} Information required to be disclosed in that Schedule includes the acquirer’s identity and background, the amount and sources of the funds for acquisition, the purpose of the acquisition, etc.\textsuperscript{44} Thenafter, acquirers are under continual obligations to disclose, among others, its further acquisition of the target’s shares. That is, if any material change occurs in the facts set forth in the Schedule 13D, including, but not limited to, any material increase or decrease in the percentage of the class beneficially owned, the acquirer shall promptly file with the SEC an amendment disclosing that change.\textsuperscript{45} Such disclosure obligations, however, are not unique to either the U.S. or the Market Rule; other countries adopting different control transaction regimes also impose similar disclosure obligations upon acquirers.\textsuperscript{46}

The second valve relates to the fiduciary duty of the target’s incumbent controlling

\textsuperscript{39} For an introduction of the Market Rule in the U.S., see Davies & Hopt, supra note 2, at 257-58; Schuster, supra note 2, at 535-39.

\textsuperscript{40} The controversial Perlman v. Feldman case may be the closest one to the mandatory bid rule, see Perlman v. Feldmann, 219 F.2d 173 (2d Cir., 1955), cert. denied, 349 U.S. 952 (1955). Andrews, for instance, argued that this case introduced a sharing rule into the U.S. and should be applauded. See generally Andrews, supra note 2. Easterbrook and Fichel, in contrast, disagreed with the court’s reasoning and conclusion. Easterbrook & Fichel, supra note 2, at 716-19. For other discussion of this case, see e.g., Richard W. Jennings, Trading in Corporate Control, 44 Cal. L. Rev. 1 (1956).

\textsuperscript{41} For subsequent U.S. cases denying the mandatory bid rule in the U.S. see e.g., Essex Universal Corp. v. Yates, 305 F.2d 572 (2d Cir. 1962); Zetlin v. Hanson Holdings, Inc. 48 N.Y.2d 684, 421 N.Y.S.2d 877, 397 N.E.2d 387 (1979).

\textsuperscript{42} A.L.I. PRINCIPLES OF L., CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 5.16 (1994).


\textsuperscript{45} Rule 13d-2(a), 17 C.F.R. § 240.13d-2(a) (1998). More specifically, “[a]n acquisition or disposition of beneficial ownership of securities in an amount equal to [1%] or more of the class of securities shall be deemed ‘material’ for purposes of this section; acquisitions or dispositions of less than those amounts may be material, depending upon the facts and circumstances.”

\textsuperscript{46} For instance, within the Partial Offer Rule camp, Japan, for example, imposes disclosure and reporting obligation on “large-volume holder.” See Financial Instruments and Exchange Act arts. 27-24 & 27-25 (Japan). Taiwan, for example also imposes similar obligations on shareholders holding more than 10% of shares of a public company. See Securities Exchange Act art. 43-1(1) (Taiwan).
shareholders. Under current case laws, an incumbent is subject to the duty of fair dealing to other shareholders, including making necessary disclosure concerning the transaction to other shareholders and, among others, “refraining from engaging in transaction with a purchaser who, as apparent from the circumstances, is likely to violate the duty of fair dealing in such a way as to obtain a significant financial benefit for.” The rationale for imposing such a fair dealing duty upon the target’s incumbent is out of two main concerns: that other shareholders are at a relatively difficult position to prove the acquirer’s breach of fiduciary duty, and that the acquirer may be unable to fully compensate minority shareholders and in that event, “the more efficient approach is to prevent the transaction in the first place.” In that sense, the incumbent’s such duty to minority shareholders is essentially derivative to the acquirer’s duty. That is why case laws generally hold that minority shareholders’ claim against the target’s incumbent should not be accepted unless either the acquirer later on actually breaches the duty of fair dealing or the acquirer’s breach is prevented by injunction or similar action from doing so initiated by minority shareholders. In sum, by virtue of this special fiduciary duty, the U.S. regime wishes to reduce the rate that the target is sold to a looting acquirer.

What warrants some emphasis here is that, under current case laws, the incumbent’s such liability will not be imposed unless it is “apparent from the circumstances” that the acquirer is likely to violate the duty of fair dealing and obtain a significant financial benefit. According to the ALI’s comment, “affirmative investigation by the controlling shareholder is not required in the absence of facts that would alert a reasonable person to the need for further inquiry” and “the mere fact that the controlling shareholder receives a substantial premium for its shares, or that the purchaser has a general reputation for aggressive acquisitions, is not itself sufficient to trigger such an inquiry.” This is apparently a loose standard. In fact, under current case laws, incumbent controlling shareholders are rarely found liable.

ii. The General Offer Rule in the EU

The EU, on the other hand, adopted the Directive 2004/25/EC (the “Takeover Directive”) in 2004 and introduced the General Offer Rule. Under the Takeover Directive, if a party holds shares of a company which gives it a specified percentage of voting rights in that company and thereby giving it control of that company, Member States shall ensure that such a party is required to make a bid addressed to all the holders of those shares for all their holdings at the equitable

49 Id. comment (e).
50 Id.
51 For some critics of this fiduciary duty approach, see Easterbrook & Fischel, supra note 2, at 718-19.
53 For a criticism of the U.S. Market Rule, see generally Schuster, supra note 2, at 537-38.
price. The Directive, however, does not specify purchasing how much voting right amounts to a control transaction. In addition, except stipulating that the offer price should be “equitable,” the Directive does not identify what price shall be offered to the target’s shareholders. These are left to the Member States’ discretion. Member states are also permitted to determine the criteria for exempting the mandatory bid procedure. In implementing the Takeover Directive, the United Kingdom, the leader of the European General Offer Rule, stipulates the controlling threshold as 30%. Austria, Italy, Belgium, France, Germany, the Netherlands Russia and Spain also maintain the same threshold.

There are two major justifications for the General Offer Rule. First, the General Offer Rule can prevent coercive takeover. It is argued that, under the Market Rule which contains no mandatory bid obligations, an acquirer can coerce the target’s minority shareholders to sell their shares to her by telling each minority shareholder that if he/she does not tender his/her shares in the first place while other shareholders do, after the acquirer acquires the target’s control and launches a second round acquisition to acquire remaining outstanding shares, the acquisition price in the second round will be lower. Fearing the lower acquisition price in the second round, minority shareholders will tend to tender their shares in the first round, but such tendency could be a distorted choice and do not reflect rational decision of most shareholders. The General Offer Rule can prevent such coercion since the mandatory bid obligation plus the equitable price requirement together guarantee minority shareholders that even if they wait until the second round, the acquisition price they will receive remains equitable instead of coercive. In this aspect, the General Offer Rule can secure the rationality of the target’s shareholders’ decisions and therefore better protect minority shareholders’ interests.

Second, the General Offer Rule can prevent value-decreasing transactions. It is argued that an acquirer’s purpose of acquiring the target is not always value-increasing; it could be the case that the acquirer simply aims at looting private benefits from the target (such as tunneling the target’s asset into its own pocket) instead of enhancing the target’s corporate performance. As long as an acquirer does not 100% hold the target, such extraction can be profitable to the acquirer because the corporate value that the acquirer loots from the target always exceeds the acquirer’s loss in the target’s share price from such extraction: on the one hand, the acquirer tunnels 100% of that extracted value into her own pocket, but on the other hand, while such extraction also reduces the target’s value and therefore the target’s share price, which should also incur loss to the acquirer to the extent of the acquirer’s shareholding of the target, the acquirer’s share price loss is not equal to 100% of the extracted value as other shareholders of the target will also undertake some losses. In fact, the fewer shares the acquirer holds, the more profits she can reap by tunneling the target’s

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55 Takeover Directive art. 5 (EC).
56 Takeover Directive arts 5.3 & 5.4 first paragraph (EC).
57 Takeover Directive art. 5.4 second paragraph (EC).
59 See Davies & Hopt, supra note 2, at 252-53.
value. By adopting the General Offer Rule, acquirers are forced to acquire more shares of the target, which decreases the acquirer’s incentive to loot the target’s value. In particular, if all shareholders tender their shares to the acquirer, looting no longer brings profits to the acquirer. In light of that, looting acquirers may find acquisition less profitable and thus exit the capital market, leaving the market with more value-enhancing acquirers. In this aspect, the General Offer Rule can screen out bad acquirers and leave the market with more good acquirers.

b. The Missing Piece: the Partial Offer Rule with Its Independent Character

Many literatures have provided in-depth comparative analysis between the Market Rule and the General Offer Rule. Early discussion focused on whether the target’s minority shareholders deserve an equal treatment, be it in the form of entitlement to the control premium of the target, the right to participate in the sale of their shares, or the opportunity to exit the target when the target experiences change of control. Professor William Andrews, for instance, insisted on the principle of equal treatment by drawing reference from merger and asset acquisitions and argued that control transactions should follow the similar rules governing merger and acquisitions, i.e. “inside and minority stockholders share alike; the insiders get no bonus to reflect the greater investment value of their holdings.” Other commentators, in contrast, deny the need of this sharing rule.

Recent discussions shift the focus to the efficiency dimension, which concentrates on the efficiency costs of these two rules in terms of blocking efficient transactions and permitting inefficient transactions. On this aspect, Professor Lucian Bebchuk provides a comprehensive analytical framework for assessing how each control transaction rule has its impact on efficient and inefficient transactions. He firstly clarified that both the acquirer’s and the incumbent’s interests are comprised of two elements: the corporate value of the target and the private benefit looted from the target. He then conducted economic analysis to demonstrate the condition for the incumbent and the acquirer to reach a deal under each of the Market Rule and the General Offer Rule. By defining efficient transactions as those control transactions that transfer the target to an acquirer which brings more corporate value to the target, he demonstrated that the Market Rule may introduce more efficient transactions but also more inefficient transactions, while the

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61 For instance, assuming that A Company issues 1 million shares, of which B holds 0.75 million shares. If B tunnels $1 million of A’s asset into B’s own pocket, A Company suffers a loss of $1 million and its share price should decrease $1 (i.e. $1 million tunneled asset divided by $1 million total issued shares). Through this tunneling, B earns $1 million; although the value of its A’s stock also reduces, the total loss to B is only 0.75 million (i.e. $1 reduced share price times 0.75 million that is B’s total amount of shareholding). The difference, i.e. $0.25 million, is undertaken by A’s other shareholders. The fewer shares that B holds, the more profits it makes from tunneling A’s assets. In any event the tunneling is worthwhile.

62 This is what Easterbrook and Fischel advocates, see generally Easterbrook & Fischel, supra note 2.

63 For a brief account of how the legal constraint strategies encounter their limits, see Luca Enriques et al., The Basic Governance Structure: The Interests of Shareholders as a Class, in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, supra note 2, 55, 79-81.

64 Andrews, supra note 2, at 535-36.

65 See e.g., Easterbrook & Fischel, supra note 2; Hansen, supra note 2; Elhauge, supra note 2.

66 To be fair, earlier discussions also touched upon the efficiency dimension, see Andrews, supra note 2, at 517-19; Javaras, supra note 2, at 425-27.
General Offer Rule prevents all inefficient transactions but also more efficient transactions. On this basis, Professors Paul Davies and Klaus Hopt argued that while the General Offer Rule can discourage looting acquirers, it also blocks control transactions in general, which is undesirable especially in countries with concentrated shareholding structure to the extent that it makes it even more difficult to eliminate incumbent controlling shareholders. Professor Edmund-Philipp Schuster, in contrast, held different position: he applied Bebchuk’s analytical model to scenarios involving competing bidders and demonstrated that, when competing bidders exist, the General Offer Rule is more efficient than the Market Rule.

In these threads of discussion, we find the Partial Offer Rule somehow muted. Most literatures did take note of the existence of the Partial Offer Rule as a distinct regime from the Market Rule and the General Offer Rule. Nevertheless, in most cases, commentators simply treat the Partial Offer Rule as a variation of the General Offer Rule and mix them together, which downplays the independent character of the Partial Offer Rule. In the end, we fail to observe much discussion devoted specifically to the Partial Offer Rule. The following part of this paper anticipates to supplementing this inadequate attention.

III. THEORETICAL FOUNDATIONS OF THE PARTIAL OFFER RULE: TRANSFORMING THE DICHTOMIZED DEBATE INTO A TRICHOTOMIZED ONE

In this Section, we will compare three control transaction regimes, namely, the Market Rule, the General Offer Rule and the Partial Offer Rule, but engage in more independent assessment of the latter. In particular, we expand Bebchuk’s analytical framework by adding the factor of cost of funds, which makes a more convincing case for the Partial Offer Rule. We then employ a filter perspective to demonstrate the theoretical advantage of the Partial Offer Rule, especially its inbuilt “filter” mechanism designed on the basis of the incumbent controlling shareholder’s “skin in the play.”

A. A Confirmation of the Benchmark to be Applied: An Efficient Term

Before proceeding to the economic analysis, we have to determine the analytical approach to be applied. In our view, the dichotomized debate between the Market Rule and the General Offer Rule can be boiled down to a struggle between the protection of minority shareholders and the facilitation of control transaction. On the one end, the General Offer Rule in general affords more protection to minority shareholders by, for instance, providing them equal opportunity to sell their shares and exit the target company, according them entitlement to control premium, and protecting them from coercive acquisition, etc. On the other end, the Market Rule performs better in facilitating control transactions, which permit more value-decreasing deals but also more value-

67 See generally Bebchuk, supra note 2.
68 Davies & Hopt, supra note 2, at 258-59.
69 See generally Schuster, supra note 2.
70 For instance, Davies and Hopt did mention the Japanese Partial Offer Rule at the beginning, but later on their discussion focuses on the Market Rule in the U.S. and the General Offer Rule in EU. See Davies & Hopt, supra note 2. Schuster also classified Japan’s and Canada’s Partial Offer Rules as a variation to the General Offer Rule rather than an independent category. See Schuster, supra note 2, Fn 9.
71 One exception is Bebchuk’s paper, which provides an independent analysis of the Partial Offer Rule, but his ultimate finding still considers the Partial Offer Rule generally identical to the General Offer Rule. See Bebchuk, supra note 2, at 968-71.
increasing deals as well. To determine which one dominates in the end may be simplified into asking if a country is willing to pursue more control transactions in sacrifice of the protection of minority shareholders or instead go for the other interest.

In our view, this give-and-take in essence is a welfare creation versus fairness debate, and in the field of laws and economics such debate is not unfamiliar.

a. Equality or Efficiency? A Functional Term of the Protection of Minority Shareholders

On the battle between welfare and fairness, Professors Louis Kaplow and Steven Shavell have well elaborated their view. In a nutshell, they employ the normative framework of welfare economics and argue that the evaluation of legal rules should be entirely based on welfare economics and give no weight to the notion of fairness. They downplay the significance of “fairness,” arguing that fairness is an incomplete concept that lacks concrete basis for determining its scope of application. They further argue that the concept of “fairness” is nonconsequentialist in the sense that it often pursues a particular outcome from an ex post perspective but ignores how a given rule will pose ex ante effect on the affected individuals’ behaviors and reshape the structure and well-being of the affected individuals. Overall speaking, they are skeptical of applying fairness when designing laws, especially when the pursuit of fairness will not make the well-being of any affected individual better off.

Applying this observation to the area of corporate laws, while the concept of equal treatment of shareholders may in itself be a virtue, what makes this very concept a valid principle should be its functionality, especially its function as an incentive strategy that binds the controlling shareholder and “motivates her to act in the interests of shareholders as a class, which includes the interests of minority shareholders.” This point can be better illustrated by Kaplow’s and Shavell’s argument that it is undesirable if the pursuit of fairness does not make the well-being of any affected individual better-off. In the corporate world, shareholders should be the major individuals affected by corporate laws, especially when it involves the Type II agency cost, i.e. the conflict of interest between controlling shareholders and minority shareholders. While the well-being of an individual is difficult to be defined in principle, to define the well-being of shareholders in the corporate world is relatively simple. That is, considering that corporations can be generally understood as profit-seeking entities and that shareholders investing in a company generally aim to seek profits, shareholders’ well-being can in general be simplified into their financial interests derived from the invested company. This well-being in financial terms can be

72 See generally LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE (2002).
73 Id. at 3-4.
74 Id. at 45-46.
75 Id. at 47-51.
76 Luca Enriques et al., The Basic Governance Structure: Minority Shareholders and Non-shareholder Constituencies, in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, supra note 2, 89, 96-99 (Enriques et al. further illustrate that “all jurisdictions rely on this device over at least some set of circumstances to align the incentives of controlling and minority shareholders.”)
77 John Arour et al., Agency Problems and Legal Strategies, in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, supra note 2, 35, 36.
78 Because under welfare economics the well-being of an individual is not limited to monetary interest, but “everything that an individual might value” that is unrestricted to hedonistic and materialistic enjoyment. See KAPLOW & SHAVELL, supra note 72, at 18-24.
in turn simplified into the company’s value since shareholders have residual claim against the invested company’s value: when a company’s value increases, its shareholders benefit through either the increase in dividend or the increase in the value of their stocks in open markets; either way increases shareholders’ financial well-beings. From this perspective, if equal treatment or any protection of minority shareholders is of any virtue, its virtue should result from that these principles incentivize the company’s controlling shareholder to maximize the company’s value and thereby benefit all shareholders. If, to the contrary, equal treatment or any protection of minority shareholders in the end reduces a company’s value, such claimed “equal treatment” or “protection” does not really protect minority shareholders since it simply reduces the well-being of all shareholders. In light of the above, we are skeptical of over-emphasizing the idea of protection of minority shareholders or equal treatment of minority shareholders per se.

To be sure, we are not saying that one should not be sympathetic of minority shareholders’ interest. Our position is rather to cast a doubt about what treatment awarded to minority shareholders is considered “equal” enough: what is the exact meaning of “fairness” or “equal treatment” of shareholders? In the context of control transactions, a control transaction regime implicates the allocation of interest between those shareholders having access to private transactions (usually the incumbent controlling shareholder) and other left-out shareholders (usually the minority shareholders); it is unclear to us why distributing the interest originally accrued to the former to the latter is more equal. The reach of the concept of equal treatment is too floating and uncertain to reach definite conclusion. Absent inquiries into its functionality, we fail to see how the concept of “fairness” or “equal treatment” sheds enough light for answering this question.

Similarly, we do not find traditional inquiries centered on the assignment of the target’s control premium valid here. Again, without considering the functionality implication, there is absent a concrete enough criterion for determining which party should be assigned of the control premium. The assignment of the control premium in fact resembles a “zero-sum” game between minority shareholders and the controlling shareholder: one party’s earning is the other party’s loss, and in this game we fail to see why minority shareholders should necessarily prevail. Borrowing the wisdom of Kaplow and Shavell, the assessment from an ex post perspective that focuses on which way of assigning the control premium is fair or just is nothing but thinly grounded. What we should instead assess is, from an ex ante perspective, which way of assigning the control premium will change the behavior of related individuals and thus maximize the well-being of every individual. Focusing on which way of allocating the control premium cannot shed us too much light here.

Those arguments centering on minority shareholders’ exit right sound incomplete to us as well. As long as the target is a public company and does not go private immediately after the acquisition, its minority shareholders always retain a venue to exit the target, that is, selling their shares in the public market. Hence, the real problem is less about the opportunity to exit per se than the exit

79 Enriques et al., raised the same question and observed that “[i]nsofar as shareholder preferences are heterogeneous and controlling shareholders have legitimate power to shape corporate policy, some level of unequal treatment seems endemic to the corporate form.” Enriques et al., supra note 76, at 96.
80 Id. at 96-99 (observing that “the reach of the equality norm varies greatly, both within and between jurisdictions.”)
81 For a subtle analysis of how the principle of equal treatment differs with the control premium concept when applying to the case of control transaction, see Andrews, supra note 2, at 526-27.
price. To illustrate it, assuming that the market perceives the acquirer an inefficient controller. With that perception, the post-acquisition market price should be lower than the acquisition price since the market anticipates a poorer performance of the target under the inefficient acquirer’s control. In that case, which price should be the “fair” exit price, the acquisition price or the market price? The General Offer Rule appears to award minority shareholders the acquisition price while the Market Rule leaves them only with the post-acquisition market price. One could argue that, to afford better protection to minority shareholders, laws should provide minority shareholders the higher price, i.e. the acquisition price. However, “more” is not necessarily “fair.” One could make an equally convincing argument that minority shareholders should receive only the lower market price since they are not guaranteed profits in the public market and they should be responsible for their own investment judgment. Again, without further inquiring into the functionality implication, we have little ground for deciding whether minority shareholders should be entitled to an exit right upon control transactions and how much the exit price should be.

To sum up the above, we prefer to assess control transaction regimes from the perspective of efficiency. This assessment will largely follow the analytical framework developed by Bebchuk which evaluates whether a control transaction regime fosters more efficient transactions while at the same time precludes more inefficient transactions. The following question would then be: how to define efficiency?

b. Company-Centric or Investors-Centric? Corporate Value or Stock Value?

As to how to determine if a transaction is efficient or inefficient, Bebchuk proposes to assess if a control transaction increases the target company’s value: if a transaction transfers the target’s control to an acquirer creating more value to the target compared with the incumbent controlling shareholders, it is an efficient transaction since it increases the value of the target company. This increase in value is socially desirable since it maximizes the society’s aggregate well-being, and it also benefits all shareholders, including minority shareholders, since the increase of the target’s value will raise the target’s stock price and accordingly benefit all shareholders. Under this framework, if a control transaction regime does not offer equal treatment to minority shareholders but fosters more efficient transactions and/or precludes more inefficient transactions, even though minority shareholders are not vested with any nominal entitlement, such regime is worth pursued because eventually the well-beings of all shareholders are improved. To the contrary, if a regime provides minority shareholders with various nominal entitlements but in effect blocks more efficient transactions and/or fosters more inefficient transaction, all these entitlements are merely empty vases. Hence, the assessment of different control transaction regimes shall focus on which one brings more value to the target company. We term this approach as a “company-centric” benchmark as what it concerns is the company’s value.

While we generally agree with the above deduction, we wish to highlight another benchmark in addition to the company-centric one, that is, an “investor-centric” one. To elaborate, under Bebchuk’s analytical framework, a company’s value is comprised of two elements: (i) the value its controller creates minus (ii) the private benefits its controller loops. A controller who is

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82 For literatures holding similar views, see e.g., Javaras, supra note 2, at 428; Easterbrook & Fichel, supra note 2, at 703-04, 715-19.
83 Bebchuk, supra note 2, at 963.
84 See generally id. at 961-64.
good at creating value for the company can at the same time loop even more. Introducing such kind of acquirer to become the target’s new controller does not necessarily benefit other non-controlling shareholders of the target; they could in the end be worse-off. For instance, assuming Company A, under the incumbent controlling shareholder B’s control, produces corporate value of $1 million, while A issues 1 million shares and B holds 0.6 million of them. Assuming now B plans to sell her all shares to the acquirer C who is able to produce $1.2 million corporate value but will also loop 0.4 million into her own pocket. This control transaction is value-increasing since A’s value will increase for 0.2 million. However, the share price before the acquisition is $1 per share, while that after the acquisition will be only $0.8 per share. To A’s other non-controlling shareholders, this claimed “value-increasing” transaction is nothing but value-decreasing. Should control transaction regimes let go such type of transactions? If we adopt the company-centric view, perhaps the answer is positive. In such case, we see a discrepancy between corporate value and stock price. 85 Which one should serve the metric to be maximized then requires further discussion.

If adopting standard economic analysis which uses a rather simple measures of social welfare and accords no importance to the distribution of utilities, 86 one might prefer the company-centric view. The rationale is as follows: law and economics aims at maximizing the overall well-being of the society. In the corporate world, this is done by maximizing each individual company’s value so as to in aggregate increase the society’s well-being. In this aspect, introducing a value-increasing controller to each individual target is of importance since this ensures the target being managed in a manner maximizing its value. In contrast, whether the controller loots from the target matters little, if any, since looting activities are only about the allocation and distribution of corporate value, not about the creation of corporate value, therefore not a concern under the metric of social well-being maximization. 87 From that perspective, one might prefer introducing a value-increasing but looting acquirer. Even if other non-controlling shareholders thus become worse-off, standard economic analysis might consider it a worthwhile tradeoff. 88 While this position is straightforward and clear-cut in the sense that it embraces one clear benchmark, i.e. social wealth maximization, it risks the critics of ignorance of allocative efficiency and distributional justice. 89

Modern welfare economists, on the other hand, attempt not to downplay the importance of distributional justice. They concern the potential welfare effect that may be caused by distributional injustice and take into account such effect when calculating if the overall well-being

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85 In fact, some literatures do suggest to place primary emphasis on shareholders’ stock returns, see e.g., Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 35-36.
86 Steven Shavell, Foundations of Economic Analysis of Law 3-4 (2004) (summarizing the basic reasons for standard economic analysis to ignore distribution concerns, such as leaving this issue to income tax and transfer system.)
87 Moreover, one might argue that corporate rules may have little effect on distribution of income since most investors will be on each side of a type of transaction equally often. Kaplow & Shavell, supra note 72, at 33.
88 For instance, Bebchuk’s analytical framework appears adopting this company-centric view. Bebchuk, supra note 2, at 963.
89 For further discussion of the seriousness of distribution issues under economic analysis framework and how to tackle distribution issues within this framework, see e.g., Anthony B. Atkinson, Inequality: What Can Be Done? (2015); Joseph E. Stiglitz, The Price of Inequality: How Today’s Divided Society Endangers Our Future (2013).
of the society is increased. For instance, Kaplow and Shavell are cautious of over-extending their welfare maximization arguments. They emphasize over and over again that their preference for welfare maximization only holds in a setting that the pursuit of fairness does not make any affected individual better-off or makes everyone worse-off: for cases where one policy increases the aggregate well-being of the whole society but makes “some” affected individual worse-off, they take no specific position. In particular, they acknowledge that fairness can have its independent value which in turn has effects on individual well-beings, and this should be calculated in when assessing the overall well-being of the society. Applying that understanding here, perhaps one cannot characterize the non-controlling shareholders’ loss caused by looting as a distributional issue and simply ignore it. Instead, one should consider the welfare effect of the non-controlling shareholders’ loss. Specifically, perhaps one should concern not only the non-controlling shareholders’ loss of interest per se, but also other potential spillover effect which could lead to efficiency loss. For instance, consider its impact on the sustainability of capital markets: if a control transaction regime is designed in a manner that tends to be disadvantageous against non-controlling shareholders, general investors may become less willing to enter into the stock market, resulting in a less vibrant capital market. This is why protection of minority shareholders and investors is always a crucial topic in corporate and securities laws. If taking that spillover effect into account, perhaps the investors-centric view, in addition to the company-centric view, is another dimension in need of attention. Admittedly, it may be difficult to quantify the actual cost of the spillover effect caused by inadequate protection of minority shareholders for determining the overall welfare gain or loss. But still, we believe this “investors-centric” view of at least equivalent importance when assessing different control transaction regimes.

In the remaining part of this paper, we will bear in mind the different implications of these two views when we evaluate the “efficiency” of different control transaction regimes.

B. Economic Analysis of Different Control Transaction Regimes

Among the three control transaction regimes we are going to compare, one might intuitively consider the Partial Offer Rule in the middle between the Market Rule and the General Offer Rule. Whether this intuition is true, however, requires more nuanced assessment.

a. Conditions for Reaching a Deal under Each Regime

Let us invoke Bebchuk’s analytical framework first to make the comparison. We start our analysis from the Market Rule.

i. The Market Rule

Assuming that a target company T, which issues X amount of shares, is with an incumbent controlling shareholder I who holds Y amount of T’s issued shares (Y is smaller than X, meaning

90 See e.g., KAPLOW & SHAVELL, supra note 72, at 52.
91 Id. at 394-96.
92 There are in fact some literatures instead adopting this investor-centric approach and looking at the stock price when developing their analytical frameworks. See e.g., Easterbrook & Fichel, supra note 2, at 707-08.
93 Our analytical framework basically resembles that of Bebchuk, except that we conduct our analysis from an aggregate lens built on assumed total value and total private benefit, while Bebchuk’s analysis is from an average lens built on assumed value per share and private benefit per share. The result, however, should not be different.
that T has other non-controlling shareholders). Assuming further that the incumbent creates value of \( V_I \) in total for A, but she also loots private benefit of \( P_I \) in total from A. In such scenario, the well-being per share of the incumbent (denoted as \( W_I \)) and other non-controlling shareholders of the target (denoted as \( W_{NI} \)) is as follows:

(1) \( W_I = (V_I - P_I) / X + P_I / Y = (V_I + (X/Y - 1) \times P_I) / X \), while

(2) \( W_{NI} = (V_I - P_I) / X \)

If now there is an acquirer A who plans to acquire T’s control by acquiring shares from I. Assuming further that A creates value of \( V_A \) in total for T, but she also loots private benefit of \( P_A \) in total from T. After the acquisition, the well-being per share of the acquirer (denoted as \( W_A \)) and that of other non-controlling shareholders of T (denoted as \( W_{NA} \)) is as follows:

(3) \( W_A = (V_A + (X/Y - 1) \times P_A) / X \), while

(4) \( W_{NA} = (V_A - P_A) / X \)

Under the Market Rule, which imposes barely any restrictions on the transaction between I and A, a deal can be reached as long as \( W_A > W_I \), since in that case the acquirer A is willing to offer price higher than the incumbent controlling shareholder I’s well-being. That is:

\[
(V_A + P_A \times (X/Y - 1)) / X > (V_I + P_I \times (X/Y - 1)) / X , \text{that is,} \\
(V_A - V_I) > (X/Y - 1) \times (P_I - P_A) \, (\text{while } X/Y - 1 \text{ by definition is } > 0)
\]

Under this condition, one can find that the Market Rules cannot block all value-decreasing transactions. To illustrate it, based on Function (5), it is apparent that even if \( V_A \) is less than \( V_I \), which makes the left part of the function negative, there remains a likelihood that the above condition is met. That is, as long as \( P_A \) exceeds \( P_I \) significantly enough which makes the right part of the function more negative, the condition can still be met. Put this in an intuitive description, even if the acquirer is unable to create more value than the incumbent controlling shareholder, as long as she loops the target’s value into her pocket additional enough, the deal can be reached between both parties. Under both the company-centric and the investors-centric lens, this is not desirable. The company-centric lens disfavor these transactions simply because these transactions transfer the target to a controller that decreases the value of the target, which is against the corporate value maximization objective. The investors-centric lens disfavor them because these transactions transfer the target to a new controller who is not only value-decreasing but also more looting, and these two elements combine together simply reduce the target’s stock price. That said, the Market Rule simply cannot block these inefficient control transactions.

On the other hand, one can find that, under the condition of Function (5), the Market Rule blocks some efficient control transactions as well. To illustrate it, under Function (5), even if \( V_A \) is more than \( V_I \), a deal cannot be reached if \( P_I \) is significantly higher than \( P_A \). That is, if the incumbent controlling shareholder loops too much value from the target, she may be so deeply interested in her control over the target that renders her unwilling to give up the control. This is again undesirable under both the company-centric and the investors-centric lens. For the former, this means that some value-increasing deals cannot be reached, which is again against its corporate value maximization objective. For the latter, this means that the Market Rule may block a
transaction that transfers the target from a low-value-more-looting incumbent controlling shareholder to a high-value-less-looting acquirer, a transaction which increases the stock price of the target and benefits all shareholders. That said, the Market Rule still blocks these efficient transactions.  

ii. The General Offer Rule

Now we turn to the General Offer Rule. The General Offer Rule’s impact on the incumbent controlling shareholder remains the same with that of the Partial Offer Rule: the incumbent’s entitlement to sell her controlling block is not directly hindered by the rule. Therefore, the incumbent’s well-being per share under the General Offer Rule remains the same with that as shown in Function (1). In contrast, the acquirer is subject to more stringent restrictions: if she acquires a controlling block, she is obliged to offer to all non-controlling shareholders to purchase all the shares they tender. In that case, the well-being per share of the acquirer differs with that as shown in above Function (3). To illustrate it, assuming that all non-controlling shareholders tender their shares to the acquirer, the acquirer will find it meaningless to loot any asset from the target as the looting simply equates switching her asset from her left hand to her right hand. Absent the factor of $P_A$, the well-being per share of the acquirer should be now completely determined by the value she brings to the target, that is:

\[ W_A = \frac{V_A}{X} \]

In that setting, the condition for the incumbent controlling shareholder and the acquirer to reach a deal (i.e. $W_A > W_I$) should now look as follows:

\[ \frac{V_A}{X} > \frac{(V_I + (X/Y - 1) \times P_I)}{X}, \] that is,

\[ V_A - V_I > (X/Y - 1) \times P_I \] (while both $X/Y - 1$ and $P_I$ by definition are $\geq 0$)

Under this condition, since the right part of the function is by definition $\geq 0$, a transaction cannot be reached unless the acquirer creates more value than the incumbent. Therefore, the General Offer Rule can guarantee to block all value-decreasing transactions. That is, unlike the Market Rule which still permits some value-decreasing transactions, the General Offer Rule does not. This is desirable from the company-centric perspective. Moreover, it is also desirable from the investors-centric perspective: since only those value-increasing transactions can be proceeded under the General Offer Rule, while under the General Offer Rule the acquirer will not engage in looting as mentioned above, the transactions that are permitted under the General Offer Rule are necessarily those that increase the stock price of the target as well. In sum, the General Offer Rule promises that it only permits efficient transactions.

This sounds desirable, but it comes with a price. The General Offer Rule at the same time blocks more efficient transactions as well. Based on Function (7), for a transaction to be reached, the acquirer has to create not only more value than the incumbent does, but also additional enough value that exceeds the incumbent’s private benefit to a significant level. Most importantly, if we compare between Functions (5) and (7), it is apparent that acquirers under the General Offer

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94 The result so far resembles that of Bebchuk. See Bebchuk, supra note 2, at 965-68.
95 In fact, the fewer shares the incumbent controlling shareholder holds, the more additional value the acquirer needs to make.
Rule must create more additional values than those under the Market Rule in order to reach the deal: the additional value must surpass the total private benefits of the incumbent multiplied by a multiplier, not just the difference between both parties’ private benefits. Therefore, the General Offer Rule should block more efficient transactions than the Market Rule does. This is undesirable from both the company-centric and the investors-centric perspectives: keeping a target in the hand of an incumbent who brings less value to the company but loots more private benefit is not in line with either the corporate value maximization objective or stock price maximization objective.\footnote{The result so far resembles that of Bebchuk. See Bebchuk, supra note 2, at 968-69, 971-72.}

That said, compared with the Market Rule, the General Offer Rule erroneously blocks more efficient transactions even though it also blocks more inefficient transactions.

iii. The Partial Offer Rule

Now we turn to the Partial Offer Rule. Different with the General Offer Rule, this time the acquirer is less affected: she can purchase the target’s shares in the amount equal to that under the Market Rule. Therefore, the acquirer’s well-being per share under the Partial Offer Rule should be the same with that as shown in Function (3). In contrast, the incumbent controlling shareholder’s free exit under the Market Rule and the General Offer Rule no longer exists. As long as other non-controlling shareholders also tender their shares, the controlling shareholder cannot fully sell off her shares and exit the target. Instead, she can only sell part of her shares in accordance with the pro rata rule. For the rest of her unsold shares, their value depends on the performance and looting, if any, of the acquirer. If we assume for simplicity that all the target’s non-controlling shareholders tender their shares, the well-being per share of the incumbent controlling shareholder should be analyzed as follows.

First, before the acquisition, the incumbent’s well-being in aggregate is equal to her well-being per share as shown in Function (1) multiplied by its total shareholding $Y$, that is,

\[ (8) \quad (V_1 - P_I) \times Y/X + P_I = (Y \times V_1 + (X - Y) \times P_I) / X \]

Then, after the acquisition, due to the pro rata purchase rule, the incumbent is unable to sell all her shares. Instead, she retains part of her shares on a proportional basis: the exact amount would be:

\[ (9) \quad Y \times (1 - Y/X) \]

In addition, after the acquisition, the incumbent is not the controller of the target anymore. Now her well-being per share is the same with other minority shareholders, that is, the well-being per share of non-controlling shareholders as shown in Function (4). Therefore, her post-acquisition well-being in aggregate should be this figure multiplied by its shareholding as shown in Function (9), that is,

\[ (10) \quad [(V_A - P_A) / X] \times Y \times (1 - Y/X) = (V_A - P_A) \times Y/X^2 \times (X - Y) \]

The difference between (8) and (10) then represents the well-being that the incumbent loses during the acquisition, and we can then calculate her well-being per share lost due to the acquisition.
by having that difference divided by the amount of shares she sells in the tender offer, that is,

\[(11) \frac{[(Y \times V_1 + (X - Y) \times P_1) / X] - [(V_A - P_A) \times Y/X^2 \times (X - Y)]}{(Y^2/X)} \]

\[= \frac{V_1 / Y + ((X - Y) / Y_2) \times P_1 - (X - Y) / XY \times V_A + (X - Y) / XY \times P_A}{(X / Y) - [V_A - P_A / X^2 (X - Y)] / (Y^2/X)} \]

In order for both the acquirer and the incumbent to be willing to reach a deal, the well-being per share to the acquirer (as shown in Function (3)) must exceed the well-being per share of the incumbent lost in the acquisition (as shown in Function (11)), that is,

\[\frac{V_A + (X/Y - 1) \times P_A}{X} > \frac{V_1 / Y + ((X - Y) / Y_2) \times P_1 - (X - Y) / XY \times V_A + (X - Y) / XY \times P_A}{X} \]

After some processing, surprisingly the above function can be simplified as follows:

\[(12) V_A - V_1 > (X/Y - 1) \times P_1 \text{ (while both } X/Y - 1 \text{ and } P_1 \text{ by definition are } \geq 0) \]

Looks familiar? Unbelievably yet true, this condition is exactly the same with Function (7), that is, the condition for reaching a deal under the General Offer Rule. This finding might support many literatures’ disregard of the Partial Offer Rule. Bebchuk reaches the same conclusion and provides an intuitional account for this finding.\(^97\) According to him, one explanation may be that the Partial Offer Rule is able to produce disincentives that discourage the acquirer from looting private benefit from the target.\(^98\) To elaborate it in an intuitive manner, since the incumbent knows that after the acquisition her remaining shares will be subject to the looting of the acquirer, she will ask for compensation when selling her controlling block to the acquirer. Such compensation, due to the pro rata purchase rule, will further apply to other non-controlling shareholders’ sale of their shares. In the end, whatever amount of private benefit the acquirer should loot from the target will be returned to the target’s all shareholders during the acquisition, which renders the acquirer’s looting activities simply meaningless. In even extremer cases, foreseeing that coming, acquirers will act the same with that under the General Offer Rule, that is, refraining from looting any private benefits into their pocket in the first place. In either way, the Partial Offer Rule’s result will be identical to that of the General Offer Rule.

Bebchuk also shows that, by appropriate design of transaction structures, the General Offer Rule and the Partial Offer Rule is inter-changeable, rendering the condition for reaching a deal under each rule the same. One might argue that the General Offer Rule should impose more capital restraints on acquirers since acquirers are required to purchase all instead of only part of the target’s shares, and for acquirers having limited availability to finance, this should be an extra cost. According to Bebchuk, however, the capital restraint on acquirers is less an issue: to produce the same result with that under the Partial Offer Rule, an acquirer subject to the General Offer Rule can either use a partially-held shell subsidiary to purchase all the target’s stock or simply purchase all the target’s stock then resell part of them.\(^99\) To elaborate it more specifically, an acquirer who has limited capital can simply borrow funds from outside finance, use the borrowed funds to purchase all the target’s shares, resell part of them, then use the resale proceeds to repay the outside finance. In this manner, acquirers subject to the General Offer Rule but

\(^97\) Id. at 969-71.
\(^98\) Id. at 969-70. See also Andrews, supra note 2, at 532-33.
\(^99\) Bebchuk, id. at 970-71.
wishing to retain only part of the target’s shares can still mimic the result of the Partial Offer Rule. This also explains why the Partial Offer Rule reaches the same result with the General Offer Rule.

\textit{b. Partial Offer Rule versus General Offer Rule: Cost of Funds Tells}

The above conclusion that the Partial Offer Rule is not significantly different with the General Offer Rule might sound counter-intuitive. Bebchuk perhaps made a logically sound argument by highlighting the role of outside finance in this counter-intuitive result.\textsuperscript{100} However, although the availability of finance alleviates some concerns, it cannot equate the purchase of a target’s all shares with the purchase of its partial shares perfectly. Here we identify one factor that would easily alter the conclusion: the cost of funds.\textsuperscript{101}

It is obvious that the General Offer Rule and the Partial Offer Rule each imposes different level of total cost on acquirers: an acquirer has to purchase all the target’s shares under the former while only part of them under the latter. This crucial factor, however, is largely ignored by current literatures.\textsuperscript{102} Bebchuk’s reasoning assumes that, in a market providing available finance, acquirers should be indifferent with this cost issue since they can obtain all necessary funds in the financial market as long as they can persuade others to be as optimistic of their acquisition plans.\textsuperscript{103} This, however, only tells half of the story. While in either case the acquirer’s acquisition plan can be funded, the cost of funds differs. If an acquirer funds its acquisition plan through loans or other debt vehicles, it has to undertake higher aggregate interest expense as the amount of debt increases. Even if an acquirer uses its own capital to fund the acquisition, it still needs to consider the opportunity cost incurred. The higher this cost of funds is, the more the two Rules should differ with each other.

To illustrate our point, assuming the unit cost of fund for purchasing each share is C. Adding this factor alters the well-being of acquirers under both Rules. Under the General Offer Rule, now the well-being per share of the acquirer is no longer that as shown in Function (6); instead, its cost of funds for purchasing X shares of the target needs to be taken into account, that is:

\begin{equation}
W_A = \frac{V_A}{X} - C
\end{equation}

Thus, for an acquirer to agree to the acquisition plan, the condition is altered from Function (7) to:

\begin{equation}
\frac{V_A}{X} - C > \frac{V_1 + (X/Y - 1) \times P_I}{X}, \text{ that is,}
\end{equation}

\begin{equation}
V_A - V_1 > (X/Y - 1) \times P_I + X \times C \text{ (while both } X/Y - 1, P_I, X \text{ and } C \text{ by definition are } \geq 0)
\end{equation}

Compared with Function (7), this revised condition becomes even more difficult to be satisfied

\textsuperscript{100} Certainly, this requires a well-functioning capital market. In countries with incomplete capital market where lenders have proper doubts, this precondition cannot stand. Javaras, \textit{supra} note 2, at 422.

\textsuperscript{101} To be sure, Bebchuk did mention the potential presence of some transaction costs that may be implicated during the process of converting the General Offer Rule into the Partial Offer Rule. See Bebchuk, \textit{supra} note 2, at 971, Fn13.

\textsuperscript{102} For instance, Andrews mentioned that for acquirers who do not intend to extract private benefits, “[t]here will be no difference between his price per share for a bare controlling block, and his price per share for any larger amount.” Andrews, \textit{supra} note 2, at 528. This observation apparently ignores the cost of funds factor. In contrast, for literatures taking note of this factor, see Elhauge, \textit{supra} note 2, at 640-41.

\textsuperscript{103} See also Andrews, \textit{supra} note 2, at 531-32.
since the increased value the acquirer brings to the target needs to cover one more factor, i.e. the cost of fund.

On the other hand, under the Partial Offer Rule, the well-being of the acquirer is no longer that as shown in Function (3) as well; instead, its cost of funds for purchasing Y shares of the target needs to be taken into account, that is,

\[ W_A = \frac{(V_A + (X/Y - 1) \times P_A)}{X - C} \]

And the condition for reaching a deal under the Partial Offer Rule is then adjusted to:

\[ \frac{(V_A + P_A \times (X/Y - 1))}{X - C} > \frac{V_I}{Y} + \frac{((X - Y) / Y_2) \times P_1 - (X - Y)}{XY \times V_A + (X - Y) / XY \times P_A}, \text{that is,} \]

\[ V_A - V_I > (X/Y - 1) \times P_1 + Y \times C \] (while both \( P_1, X/Y - 1, Y \) and \( C \) by definition are \( \geq 0 \)

After improving our analysis by adding the factor of cost of funds, we find that: on the one hand, both the Partial Offer Rule and the General Offer Rule can still block all value-decreasing transactions as found before since the right part of the function is by definition above 0, which mandates \( (V_A - V_I) \) above 0. On the other hand, a more crucial point is: although both Rules still block some value-increasing transactions, the Partial Offer Rule in effect blocks fewer. This is because, compared with Function (14), the condition set forth in Function (16) is relatively easier to be satisfied, considering that the aggregate cost of funds for purchasing a controlling block of shares (i.e. amount of \( Y \)) is by definition smaller than that for purchasing all shares (i.e. amount of \( X \)). Considering that the Partial Offer Rule blocks the same amount of inefficient transaction with the General Offer Rule does (that is, all inefficient transactions), but it permits more efficient transaction than the General Offer Rule does, the Partial Offer Rule should dominate the General Offer Rule.

The above observation can be illustrated by an intuitive account as well. As mentioned above, the General Offer Rule and the Partial Offer Rule are inter-changeable, and an acquirer subject to the General Offer Rule can mimic the result of the Partial Offer Rule if she wants. If so, why bother to impose the more stringent General Offer Rule in the first place? To the extent that imposing the more stringent General Offer Rule cannot prevent the result of the Partial Offer Rule, such imposition merely increases the transaction cost, which is a less efficient regime. In contrast, compared with the General Offer Rule, the Partial Offer Rule has the advantage of flexibility: an acquirer subject to the Partial Offer Rule can still opt to purchase all the target’s shares and pursue the result of the General Offer Rule if she wants, while laws will not impose additional transaction cost on such pursuit. Therefore, if mandatory bid rules are of any merit, they should be implemented in the way of the Partial Offer Rule rather than the General Offer Rule.\(^{104}\)

In light of the above, we believe mainstream comparative studies’ use of the General Offer Rule to represent the mandatory bid camp a mistake. In essence, the General Offer Rule is less encompassing than the Partial Offer Rule, and we argue that the Partial Offer Rule should be more

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\(^{104}\) This probably explains why earlier U.S. literatures on mandatory bid rules focused more on a set of sharing rules combining both the Partial Offer Rule and the General Offer Rule. Essentially, they were discussing the Partial Offer Rule. See e.g., Andrews, \textit{supra} note 2.
c. Partial Offer Rule versus Market Rule: An Unsettled Question

When it comes to the comparison with the Market Rule, the Partial Offer Rule’s dominance is less than clear. The factor of cost of funds is less an issue since acquirers under both Rules expend the same for their acquisition plans. The major difference still lies in that between Functions (5) and (12). In comparison, the Market Rule permits more efficient transactions in the market than the Partial Offer Rule, but it also permits more inefficient transactions.

To be fair, the difference between these two regimes may be less significant than what the functions says if one considers the fiduciary regime inbuilt in the Market Rule. The major difference between conditions as shown in Function (5) and in Function (12) lies in the presence of $P_A$ in the former. As discussed above, under the Partial Offer Rule, the acquirer’s post-acquisition private benefit is not an influential factor since either it does not exist in the first place or it is compensated during the acquisition. In contrast, it is present under the Market Rule, which affects the condition for reaching a deal. Based on these functions, one may further conclude that it is the presence of this post-acquisition private benefit that fosters more control transactions under the Market Rule. Function (5), however, does not tell the full story of the Market Rule. Note that as introduced above, the Market Rule is not completely without regard to the acquirer’s private benefit. It also imposes fiduciary duty upon the incumbent controlling shareholders, which requires them to refrain from selling their control of the target to a looting acquirer. This design of duty neatly tackles the major difference of the Market Rule with other regimes: the acquirer’s post-acquisition private benefit. Assuming that the deterrent effect of this duty works so perfectly that incumbents will never sell the target to any looting acquirers, the $P_A$ under the Market Rule will be zero. In that case, the condition for reaching a deal under the Market Rule as shown in Function (5) no longer needs to count in the non-existent $P_A$, meaning that it will be exactly the same with that under the Partial Offer Rule as shown in Function (12). In that ideal world, we no longer need to discuss which regime works better.

At least two qualifications, however, should be made here. First, it can hardly be expected that the fiduciary duty inbuilt in the Market Rule can function so well that allows the Market Rule

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105 In addition to the factor of cost of funds, Elhauge identified another factor that distinguishes the General Offer Rule from the Partial Offer Rule: the different level of diversification. He mentioned that even if acquirers are able to fund their acquisition plans, they might not prefer the General Offer Rule as under this rule their investment risks are less diversified. Elhauge, supra note 2, at 640. If one adds that risk into our analytical framework, the dominance of the Partial Offer Rule over the General Offer Rule will be more significant.

106 One may want to check if that is the case. To do so, the $W_A$ under the Market Rule, which was originally described in Function (3) should be adjusted to Function (15). The condition for reaching a deal thus should be adjusted to: $(V_A + P_A \times (X/Y - 1)) / X > (V_1 + P_1 \times (X/Y - 1)) / X$, that is, $V_A - V_1 > (P_1 - P_A) \times (X/Y - 1) + X \times C$. Note, however, that here the cost of funds factor is multiplied by $X$ instead of a smaller $Y$ in the case of the Partial Offer Rule, which should thus narrow the difference between the two regimes. But since this difference may be less prominent, the major difference lies in that between $(P_1 - P_A) \times (X/Y - 1)$ and $(X/Y - 1) \times P_1$ as before.

107 In addition, not only does the fiduciary duty imposed on the incumbents may help deterring the acquirer’s looting behaviors, but also the fiduciary duty imposed on the acquirer can serve this function. Note that after the acquisition, the acquirer becomes the controller of the target and therefore undertakes the fiduciary duty imposed by case laws on controlling shareholders, including not to loot the company. Easterbrook and Fichel believe this latter type of fiduciary duty is the one that really protects the interest of minority shareholders. Easterbrook & Fichel, supra note 2, at 718-19.
and the Partial Offer Rule perfectly aligned. The real world is in fact the other way around. Recall that the fiduciary duty imposed upon the incumbent is a pretty loose one. Given this rarely-functioning duty, one can hardly expect that \( P_A \) under the Market Rule will disappear. The presence of such fiduciary duty probably cannot improve the Market Rule as expected.\(^{108}\) To that extent, the Market Rule’s difference with the Partial Offer Rule still exists.

Second, even if the fiduciary duty is perfectly implemented, which eliminates the acquirer’s post-acquisition private benefit altogether and aligns the Market Rule with the Partial Offer Rule, the associated cost may differ. To illustrate this point, note that although under both regimes the \( P_A \) no longer exists, the way each regime reaches this result differs. Under the Partial Offer Rule, it is done through the mandatory requirement of tender offer, and the associated cost is mainly related to the tender offer process, including those incurred due to the preparation of prospectus, wait period, clearance, etc. In short, the cost would mainly concern the compliance toward each country’s securities regulatory authority. In contrast, under the Market Rule, the associated cost is mainly related to litigation, including those incurred due to the solicitation of lawsuit, evidence gathering or discovery, or even the risk of trial errors, etc.\(^{109}\) In other words, these costs mainly concern activities in each country’s court. While it is difficult to compare the magnitude of cost to be incurred under each case, the relative efficiency of a given country’s securities regulatory regime vis-à-vis court system will certainly matter.\(^{110}\)

In sum, the Market Rule overall permits more control transactions due to its imposition of less legal restriction. However, for assessing the desirability between the Market Rule and the Partial Offer Rule, this observation is an incomplete answer; one needs further analytical tools.

C. A Comparative Study of Different Control Transaction Regimes from a “Filter” Perspective

To disentangle the above puzzle, we provide a further analytical angle which focuses on each control transaction regime’s inbuilt “filter” regime.

a. Contemporary Literatures on How to Assess the Desirability of Each Regime

After conducting associated economic analyses, contemporary studies of control transaction regimes remain plagued by the question of how to further determine the superiority between different regimes. Between the Market Rule and General Offer Rule, it is generally accepted that the former permits more efficient transactions but at the same time also more inefficient ones. In contrast, while the General Offer Rule can preclude all inefficient transactions, it also blocks more efficient transactions. Thus, a simple answer would be: neither rule dominates the other.\(^{111}\)

Frankly speaking, this observation is unsurprising at all. The Market Rule imposes extremely minimal legal obstacles on control transactions; thus it fosters basically all types of control transactions, be it efficient or inefficient. In contrast, the General Offer Rule imposes

\(^{108}\) For literatures advocating the Market Rule and placing their major hope on its fiduciary duty regime, see Elhauge, supra note 2, at 641-43.

\(^{109}\) For an economic analysis of the cost of litigation, see e.g., Shavell, supra note 86, at 389-443.

\(^{110}\) For instance, Andrews argued that the sharing rule which saves the litigation cost might be more efficient. Andrews, supra note 2, at 536-37.

\(^{111}\) Bebchuk, supra note 2, at 974; Davies & Hopt, supra note 2, at 254-55, 258-60.
perhaps the most intensive restraints upon control transactions; thus it certainly frustrates more control transactions, both efficient and inefficient ones. Without further analysis, this comparison will be boiled down to a simplified question of whether having more or fewer control transactions is more desirable, but answering this question does not help in assessing the superiority between different regimes. Then how do we determine if it is the more the better or the fewer the better?

Some literatures have provided subtler analyses of different control transaction regimes’ actual effect on efficient/inefficient control transactions. For instance, Javaras, conscious of that the main point is how many inefficient transactions can be deterred, stressed that, if under present laws most control transactions are inefficient, perhaps the mandatory bid rule may be superior, but the problem is that no one knows the magnitude and frequency of inefficient transactions under current laws. For those advocating the Market Rule, Easterbrook and Fichel applied the theory of portfolio diversification to argue that investors’ risks associated with control transactions under the Market Rule is diversifiable and thus investors should prefer rules that can bring more value to the target. Barclay and Holderness further provided empirical data collected from the U.S. and showed that control transactions were normally followed by the increase in stock price which favored all shareholders, which supports the transaction-friendly Market Rule. Based on this empirical finding, Elhauge further argued that over-deterrence rather than under-deterrence should be the real problem and thus advocated the less-regulated Market Rule. Bebchuk also provided comprehensive analyses and put forward a number of hypothetical conditions for each rule to dominate the other. For instance, one of his observations was that assuming that there are multiple rounds of control transactions, the Market Rule should be able to bring more targets to the controller that creates the most value. For those advocating the General Offer Rule, on the other hand, Schuster made an insightful argument in a recent paper analyzing how the General Offer Rule introduces a more robust screening mechanism than the Market Rule when there is more than one bidder.

In this paper, we propose an additional perspective. As discussed in previous paragraphs, the metric for comparing different regimes should be about to what extent each regime permits efficient transaction while blocks inefficient transaction. The above economic analyses, however, fall short of giving us the answer. Indeed, they provide us with the conditions for reaching a deal under different regimes, but these conditions only lay out a range within which transactions can take place. Exactly where within that range will individual transactions fall on is uncertain. Taking the Market Rule for instance, while based on Function (5) we know that the Market Rule permits both some efficient and some inefficient transactions in theory, in implementation, how many efficient vis-à-vis inefficient ones proceed remains unresolved by the Function. One may

112 For earlier but less complete discussions, see Andrews, supra note 2, at 518-19.
113 Javaras, supra note 2, at 422-23.
114 Easterbrook & Fichel, supra note 2, at 711-14. Bebchuk’s analysis which proves that the Market Rule may incur less efficient cost in a market where the difference between pre- and post-acquisition value and that between pre- and post-private benefit looting are symmetric also lends support to this diversification argument. Bebchuk, supra note 2, at 975-76.
115 See generally Barclay & Holderness, supra note 2.
116 Elhauge, supra note 2, at 641-43.
117 See Bebchuk, supra note 2, at 974-81.
118 Id. at 980-81.
119 Schuster, supra note 2, at 554-57.
wonder if each control transaction regime possesses some inbuilt mechanism that tends to leave the transactions permitted under its regime mostly efficient ones.

In our view, to produce that outcome, a control transaction regime should be able to distinguish between efficient and inefficient transactions and accord different treatments accordingly. Unfortunately, to distinguish efficient transactions from inefficient ones ex ante is extremely difficult, if not impossible.\footnote{Davies & Hopt, supra note 2, at 253.} This is not like doing a math on the paper, with given figure showing the target’s current value under the incumbent controlling shareholder’s control and the future value under the acquirer’s control. It requires a forecast of the future in a real world, which is in itself subject to overwhelmingly unknown and uncontrollable factors in each individual case. This cannot be done through abstract rules or legislation bearing a general and ex ante nature. Instead, it requires related market players’ efforts and attention on a case-by-case basis. In this aspect, one way to compare different regimes may be boiled down to: how does each regime provide incentives on different market players to distinguish between efficient and inefficient transactions and accord differential treatment favoring the former, and how efficient is each regime’s such inbuilt incentive mechanism?\footnote{Elhauge raises similar inquiries in his paper defending for the Market Rule, see Elhauge, supra note 2, at 631.}

\textit{b. The Partial Offer Rule’s Use of the Incumbent Controlling Shareholder’s “Skin in the Play” as a Filter}

We start our inquiry from the Partial Offer Rule, the central theme of this paper. In our observation, the Partial Offer Rule’s filter mechanism relies on the incumbent controlling shareholder, the major affected party under this very regime. This point may be illustrated by a comparison with the General Offer Rule. Under the General Offer Rule, acquirers are obliged to purchase whatever amount of shares tendered, thus the regime basically imposes the cost of funding on acquirers. In contrast, under the Partial Offer Rule, acquirers need not purchase all tendered shares. Its acquisition cost is thus essentially similar to that under the Market Rule.\footnote{To be sure, the acquirer’s cost is not exactly the same: under the Partial Offer Rule, the acquirer might further incur some costs associated with the tender offer procedure. However, in terms of the purchase price to be paid for acquiring the control of the target, it would be generally similar.} Instead, the major party affected by the Partial Offer Rule is the incumbent controlling shareholder. This is because pursuant to the \textit{pro rata} purchase rule, the amount of shares that the incumbent can sell is in a negative correlation with the amount of tendered shares. The more other minority shareholders tender their shares, the less the incumbent may sell its shares. Therefore, under the Partial Offer Rule, the party who is placed to the forefront for protecting minority shareholders is the incumbent.

And the Partial Offer Rule does take advantage of this very feature to create a workable filter mechanism. Let us explain how this filter works. Under the Partial Offer Rule, the incumbent is basically doomed to retain some shares of the target after the acquisition. The post-acquisition value of these retained shares then plays a significant role when the incumbent makes her cost and benefit analysis of whether to agree to the proposed acquisition. As shown in Function (11), when the incumbent decides whether to agree to the proposed acquisition, she wants to make sure that the aggregate price of the sold stock, together with the aggregate value of the retained stock after the acquisition (as shown in Function (10)), can exceed the aggregate value of all these stocks.
when the target is under her control. Following this logic, the higher the post-acquisition value of her retained stocks, the more possible the proposed transaction reaches a deal (since the incumbent can tolerate a lower offer price). From this perspective, the post-acquisition value of the target’s share is of tremendous interest to the incumbent. Nevertheless, the above economic analysis of the Partial Offer Rule in fact contains one implicit but big assumption, that is, the incumbent is aware of the target’s future performance under the acquirer’s control. Specifically, we assume that the incumbent has perfect knowledge of the post-acquisition value of the target’s share. Only with that assumption can we run our inference to derive the condition for reaching a deal.

In the real world, however, this assumption for most of the time does not stand true. In most cases, the incumbent does not possess perfect information regarding the post-acquisition value of the target’s stock. To begin with, this value is a future value, which no one can perfectly predict. Besides, this value is derived from the target’s post-acquisition stock price, which is comprised of two elements: the future corporate performance of the target and the private benefit to be looted by the acquirer. After the tender offer, however, the control over the target will be transferred to the acquirer, while the incumbent will lose its control. Therefore, how much value the acquirer will create for the target and how much private interest the acquirer will loot from the target is at the disposal of the acquirer, not the incumbent anymore; the incumbent in this setting is in fact at an informational disadvantage. She does not know the future value of the target under the acquirer’s control.

The incumbent, however, is incentivized to overcome this informational disadvantage. To the extent that the acquirer’s future performance affects the incumbent’s future well-being, a rational incumbent will not be indifferent with the acquirer’s future performance when assessing whether to transfer its control to the acquirer. In this sense, the Partial Offer Rule mandates some “skin in the play” of the incumbent, which creates an incentive for her to select between different acquirers. In particular, it incentivizes the incumbent to filter out inefficient acquirers and deal with efficient acquirers as possible. This benefits the target as well as its other non-controlling shareholders.123

Entrusting the incumbent controlling shareholder with this filter role is appropriate in terms of capacity. Among the players interested in the target’s value, the incumbent is apparently more capable of safeguarding the target. First, as the controller of the target, she has the most access to the target’s information, including the general knowledge of the business and finance as well as specific knowledge of the target’s current performance and business prospects, etc. Therefore, she has better information of what kind of controller and what business plan that best fit the target. Second, she has better access to the profile of the acquirer. To seek the incumbent’s cooperation with its acquisition plan, the acquirer has to approach the incumbent through private negotiation before initiating the tender offer. This provides the occasion for the incumbent to understand better the acquirer, both the acquirer’s capacity in improving the target’s performance and likelihood of looting private benefits from the target in the future. Finally, she has the bargaining power against the acquirer. To acquire the control over the target, the acquirer needs the

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123 For literatures making similar argument for the Partial Offer Rule, see Andrews, supra note 2, at 517-18. Although Elhauge favored the Market Rule, he also appeared to show some sympathy toward the Partial Offer Rule when he criticized the General Offer Rule. See Elhauge, supra note 2, at 644.
incumbent’s cooperation. The incumbent thus has the say about whether the transaction may go forward. She even possesses the leverage to turn to other acquirers: if she is uncomfortable with her informational disadvantage as illustrated above and does not feel receiving adequate clarification from the acquirer for protecting her own well-being, she can end the negotiation and walk away. With these relative advantages in inherent knowledge, access to information and bargaining power, what the incumbent could possibly lack is only the incentive. But the Partial Offer Rule offers this last piece of the puzzle.

One might wonder if the acquirer can simply buy out the incumbent controlling shareholder. For instance, to seek the cooperation from the incumbent, can an inefficient acquirer simply raise the acquisition price to a level that “compensates” for the incumbent’s future loss in stock value? One may argue that if the acquisition price is high enough, perhaps the incumbent would be less incentivized to act its filter role. This would be less likely the case, though, for two main reasons. First, from the incumbent’s perspective, a higher acquisition price might not be necessarily a good thing. Note that the acquisition in the end has to be done through the tender offer procedure. The higher the tender offer price is, the more minority shareholders might tender their shares; then the fewer shares the incumbent may sell, and the more shares she has to retain. The incumbent thus would be exposed to the risk of stock price loss if the acquirer is inefficient. In this aspect, compensatory pricing does not necessarily provide comfort to the incumbent. Second, this acquisition strategy in fact represents a higher acquisition price and consequently a lower return to the acquirer. An efficient acquirer, aiming at maximizing its returns, would avoid using this strategy: instead, she would tend to demonstrate to the incumbent her ability to run the target efficiently. If she manages to convince the incumbent, she is rewarded with a lower acquisition price. In contrast, an inefficient acquirer cannot demonstrate so and have to pay higher compensatory acquisition price. In this sense, the Partial Offer Rule not only incentivizes incumbents to monitor potential acquirers, but also incentivizes efficient acquirers to release more private information, which reduces the informational asymmetry problem. In sum, the compensatory pricing strategy should not be a concern here; to the contrary it even helps in filtering out inefficient transactions from efficient ones.

c. Filter Mechanism of Each Control Transaction Regime

Bearing in mind that the filter mechanism of the Partial Offer Rule centers on the incumbent controlling shareholder, we now proceed to compare the filter mechanism of the Market Rule and the General Offer Rule.

i. The Market Rule: A Fiduciary Filter

The filter mechanism under the Market Rule in general consists of the fiduciary duty imposed on the incumbent controlling shareholder. In traditional dichotomized debate, the Market Rule’s such filter mechanism in fact attracts some applauds. However, we argue that when additionally considering the Partial Offer Rule and transforming the dichotomized debate into trichotomized debate, the Market Rule’s such advantage fades.

As mentioned above, under the Market Rule, there is nearly absent any legal limitation to the incumbent controlling shareholder and the acquirer. Therefore, in normal course, the incumbent

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124 Davies & Hopt, supra note 2, at 256.
should concern only the acquisition price offered by the acquirer, without regard to the future performance of the target under the acquirer’s control.  There is however one legal restraint, that is, the incumbent’s fiduciary duty to the target’s other non-controlling shareholders, in particular the duty to refrain from selling the company to an “apparent looter” as mentioned above. In the dichotomized debate, one argument for the Market Rule is that this fiduciary duty specifically imposes on the incumbent an obligation to screen acquirers carefully, which is a filter mechanism that retains efficient transactions while filters out inefficient ones. It is also a tailor-made law which applies to each individual case on a case-by-case basis and avoids the concern of over-generalization. This flexible legal design perhaps better fits the objective of regulating the control transaction.

However, here we raise three concerns of this fiduciary filter. Our first concern relates to the practicability of this fiduciary filter. To be effective, the fiduciary filter requires an effective enforcement system, preferably a robust private enforcement environment. However, except the U.S. which has a robust plaintiff lawyer structure that is active in initiating fiduciary duty claims, most countries in the world are relatively deficient in this aspect. Absent an effective enforcement system to litigate against the incumbent, any fiduciary rule, regardless how perfectly-designed, is simply a “flower in the mirror or moon in the water”, that is, an illusion. This might to some extent explain why countries implementing the Market Rule are relatively rare. For many countries, the Market Rule might be simply an “unaffordable luxury.”

The second one relates to the clarity of this legal rule. As having been noted, the standard of the fiduciary filter here is a relatively vague one: the duty exists only when “the circumstances are apparent that” the acquirer will be a looter, while the incumbent in normal course is not obliged to initiate an investigation voluntarily. It is also far from clear as to how the court should apply this “apparent circumstances” standard and when the incumbent should engage in an investigation to honor this duty. Absent a clear and enforceable standard, this fiduciary filter might not be credible enough for regulating the behaviors of the incumbent.

Our final concern relates to the adequacy of this legal rule. We note that the Market Rule and the Partial Offer Rule are similar to the extent that both rules place the incumbent controlling shareholder to the forefront. The difference is that, under the Market Rule, behaviors of the incumbent are guided less by business incentives than legal norms, under which the incumbent is legally required to refrain from engaging in transaction with an “apparent looter”. However, that an acquirer who is not an apparent looter cannot exclude the possibility that she is an inefficient controller. Accordingly, it appears to us that the fiduciary filter is limited to an extremely narrow scope. To ascertain the future performance and looting potential of the acquirer, however, calls

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125 While a higher future return of the target might render the acquirer viewing the target with higher value and thus willing to offer a higher acquisition price, it is not vice versa. A higher acquisition price does not represent that the acquirer is a more efficient one, because an acquisition price is composed of two elements: the future return of the target under the control of the acquirer and the acquirer’s private benefits derived from the target. A higher acquisition price can be equally caused by the acquirer’s tunneling of high private benefits, which is detrimental to the target and the target’s shareholders. However, whether a high acquisition price is caused by a higher future return or a higher private benefit is unobservable in itself.

126 Elhauge, supra note 2, at 1532.

127 For literatures that also cast doubts on the fiduciary filter, see e.g., Andrews, supra note 2, at 518.

128 Schuster, supra note 2, at 537-38.
for intensive investigation. The modest nature of the fiduciary filter, therefore, risks under-deterrence. Moreover, this under-deterrence problem is less likely to be fixed by simply raising the fiduciary standard. In our view, the problem here is fundamentally about the limit of legal sanction. Fiduciary duty has to concede to a large extent to refrain from over-intervening into business affairs, and we have to admit that fiduciary duty does not and cannot capture all commercially undesirable conducts. This is why corporate governance of a company cannot merely rely on legal sanctions but needs other vehicles to incentivize related market players to act to the optimum.

In light of the above, we doubt that the fiduciary filter of the Market Rule can serve well the filter function: it barely filters out anything.

ii. The General Offer Rule: A Minority Shareholders Filter

We now turn to the General Offer Rule. In our view, the General Offer Rule also contains a filter mechanism, but an extremely dim one that relies on minority shareholders.

Under the General Offer Rule, the acquirer undertakes the cost to purchase all tendered shares. The scale of such cost, however, depends on how many minority shareholders in the end tender their shares. In the above economic analysis of the General Offer Rule, we made a big assumption, i.e. all non-controlling shareholders tender their shares in the second-phase tender offer. However, this is not necessarily the case. From a rational investor’s perspective, whether to tender her shares depends on a comparison between the tender offer price and the future value of the shares. If an investor is convinced that the future value of her shares will exceed the tender offer price, she would prefer holding instead of tendering her shares. From this perspective, if the acquirer is expected to be so efficient that under her control the value of the target’s share will be higher than the offer price, perhaps fewer minority shareholders would tender their shares. In this sense, an efficient acquirer should face less capital pressure than an inefficient acquirer under the General Offer Rule. To the contrary, if minority shareholders perceive an acquirer unable to create as much value to the target company as the tender offer price, they will tender their shares. Knowing this possibility, a less efficient acquirer would be less incentivized than an efficient acquirer to initiate the acquisition in the first place. In such manner, the General Offer Rule blocks inefficient transactions. Hence, under the General Offer Rule, it is the minority shareholders’ perception of the acquirer that serves the filter.

Is it possible that the incumbent controlling shareholder considers the acquisition price high enough and prefers to sell their controlling block, while other minority shareholders consider the

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129 For instance, as Schuster has noted, if adding the dimension of synergy, which in some occasions can be a private benefit of an acquirer but can hardly be challenged under any fiduciary regime, things become more complicated and the fiduciary duty here become less available. See id. at 543-46.

130 For a comparison of the different strategies employed by corporate laws to address agency costs, see generally John Armour et al., Agency Problems and Legal Strategies, in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, supra note 2, 35, 37-50.

131 Before our analysis, we wish to mention a little that the incumbent controlling shareholder plays minimal, if any, role under the General Offer Rule. As mentioned, under the General Offer Rule, the incumbent may sell all their shares in the first-phase private transaction, meaning that it may leave no skin in the play after the acquisition. In light of this transaction structure, as long as the acquisition price is right for the incumbent controlling shareholder, she will sell her shares without regard to whether acquirer will be an efficient or inefficient one.
tender offer price relatively low and prefers to hold their stocks? Theoretically it is possible, as long as the future value of the target under the acquirer’s control is expected to be greater than the target’s current value to a significant level. For instance, assuming that the incumbent controlling shareholder controls 5 million of the 10 million issued shares of the target, and she brings $100 million profits to the target but also loots $20 million private benefit from the target. In that case, the unit share price of the target company under the incumbent’s control would be $8 per share, while the value of the shares to the incumbent is $12 per share. Now here comes an acquirer who is able to create $160 million profits to the target and she only loots $10 million private benefit. In such case, the unit share price of the target company will become $15 per share, while the value of the controlling block to the acquirer is $17 per share. Thus, the acquisition price acceptable to both the incumbent and the acquirer should range between $12 and $17 per share. However, if they reach the deal in between, say, $14.5 per share and therefore adopt this figure as the tender offer price, other minority shareholders might be reluctant to tender their shares, considering that the future value of the share is $15 per share. With fewer amount of tendered shares from minority shareholders, the acquirer may alleviate her capital pressure, the major defect of the General Offer Rule. Therefore, the scenario as contemplated in the previous paragraph is possible, at least theoretically.

Nevertheless, the above scenario is easier to be said than satisfied. To realize this theory, minority shareholders must be able to evaluate the future performance of the acquirer in order to decide whether to sell or hold their shares. However, minority shareholders, compared with the incumbent controlling shareholder, are subject to apparently more serious informational asymmetry problem.\textsuperscript{132} They have limited access to the private information possessed by the acquirer, and they have limited expertise, capacity and time to consume related information. They are also subject to the typical collective action and free rider problems, since each individual minority shareholder only possesses so tiny share of interest that makes her devotion to information gathering cost-inefficient. In light of all these factors, one can hardly expect minority shareholders to undertake the filter role well. In practice, what minority shareholders would tend to adopt as the reference against the offer price may be the current stock price, considering that this reference, as opposed to the forecast of the future value of the target, is relatively visible and simple. When the tender price appears higher than the current stock price, to expect minority shareholders to hold back their temptation to tender their shares on the belief that the target’s future value will be higher is difficult, if not impossible.\textsuperscript{133} To that extent, the minority shareholders filter under the General Offer Rule is less reliable.

iii. The Partial Offer Rule: A More Functioning Filter

Compared with the Market Rule and the General Offer Rule, we argue that the filter mechanism of the Partial Offer Rule, taking advantage of the target’s incumbent controlling shareholder, is a relatively functioning one. Compared with the minority shareholders filter of the General Offer Rule, the incumbent is at an apparently advantageous position in defending the future well-being of the target. Compared with the fiduciary filter of the Market Rule, the “skin

\textsuperscript{132} Bebchuk also notes the informational asymmetry problem the non-controlling shareholders may face under the General Offer Rule. Bebchuk, supra note 2, at 973.

\textsuperscript{133} Taking the above hypothetical case for example, how many minority shareholders can hold it back when the current unit share price of the target company is merely $8 while the acquirer offers $14.5?
in the play” design under the Partial Offer Rule, as opposed to the modest legal sanctions under the Market Rule, should better incentivize the incumbents to discharge their duty. Therefore, we argue that the Partial Offer Rule is, if not superior to, at least as theoretically valid as the other two rules.

One challenge made by current literatures against the Partial Offer Rule focuses on its undesirable impact on both the incumbents and the acquirers. The challenge goes: For the incumbents, on the one hand, they might want immediate cash and do not want to retain their shares anymore. For the acquirers, on the other hand, they might not want a blockholder, after the acquisition, retaining considerable shares of the target and posing a threat to the acquirer’s control. Due to these factors, the price for purchasing the incumbent’s all shares may differ with that for purchasing the same amount of shares but on a pro rata basis: the latter should be higher. By introducing these factors, the Partial Rule may raise the capital requirement of control transactions and thus block more efficient transactions. We do not wish to deny that, under the Partial Offer Rule, acquirers may be forced to pay more. To the contrary, we appreciate the existence of such premium which functions as compensating the incumbent and other non-controlling shareholders for their future loss and preventing the acquirers’ future looting. Admittedly, it may block some efficient transactions, but at the same time it also blocks those inefficient transactions. Most importantly, this design forces the incumbent’s stay in the target and thus incentivizes them to monitor the acquirers both ex ante and ex post. Compared with the Market Rule which provides no meaningful filter mechanism, we argue that the Partial Offer Rule’s filter possesses more teeth.

IV. THE PARTIAL OFFER RULE IN THE REAL WORLD

By demonstrating the Partial Offer Rule’s theoretical merits in the previous section, we seem to portray a rosy picture of the Partial Offer Rule. In this Section, we will provide a realistic account of the real-world implementation of the Partial Offer Rule. In particular, we demonstrate how market players under the Partial Offer Rule regime accommodate their interests with this very regime through both the transaction structure design and the interference in rules making.

A. Circumvention Through Design of Transaction Structure

As mentioned above, the major characteristic of the Partial Offer Rule is its restriction on the target’s incumbent controlling shareholder and the acquirer from engaging in private transactions according to their will. This increases the incumbent’s risk since it cannot sell off all her shares but has to retain them for some while. It also increases the acquirer’s cost since she has to not only undertake the tender offer costs but also tolerate the presence of a blockholder in her acquired company. To circumvent this restriction, the incumbent and the acquirer will naturally want to collude with each other in innovating various ways to circumvent the Partial Offer Rule.

134 Javaras, supra note 2, at 425-26; Elhuage, supra note 2, at 640-41. See also Easterbrook & Fichel, supra note 2, at 708-11 (which further identifies another separate factor, i.e. free-riding, associated with the sharing rule which may increase the capital requirement of control transactions).

135 In fact, we find these literatures a bit over-emphasizing the efficiency-preclusion aspect but downplaying the inefficiency-encouragement aspect. See e.g., Javaras, id. at 425-26; Easterbrook & Fichel, id. at 708-11.
Below we introduce some ways of circumvention and some regulatory responses.136

a. “Stay-below-the-surface” Strategy

To implement the Partial Offer Rule, a country needs a threshold for defining if a transaction constitutes control transaction and triggers the mandatory tender offer obligations. One can simply define it by a substantial approach, covering whenever an acquirer plans to obtain the control of the target. Many jurisdictions, however, opt to adopt a formal approach, i.e. defining control as a specific numerical proportion of the target’s issued shares. For instance, in Japan the numerical threshold is one-third of the target’s issued shares, in China it is 30% of the target’s shares.137 This approach certainly bears the clarity advantage, but it also incurs a conventional one-size-cannot-fit-all problem.

Apparently, a numerical threshold is a rough figure which risks over-generalization. It is fairly expected that any specific numerical threshold cannot represent the controlling threshold of each and every individual target. For instance, for a target with dispersed shareholding structures, perhaps an acquirer is able to obtain the control by acquiring only 15% of the issued shares. In contrast, for a target with concentrated shareholding structures, perhaps an acquirer after acquiring 45% of its issued shares will find it not enough. The inherently rigid nature of having a numerical threshold thus creates an easy way for acquirers and incumbents to circumvent the Partial Offer Rule, in particular for those targets with relatively dispersed shareholding structure: they can simply transfer the control while staying below the surface. This “stay-below-the-surface” strategy to some extent frustrates the very purpose of the Partial Offer Rule, which admittedly falls in the dead corner of the Partial Offer Rule.138 Unless a country determines the controlling threshold otherwise,139 this strategy is always a haunted problem.

b. “Small-leap” Strategy

If the target is with a shareholding structure that an acquirer cannot obtain the control without acquiring more than the stipulated amount of shares, the “stay-below-the-surface” strategy does

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136 Our introduction here focuses on those circumvention related to the Partial Rule, though. For some introduction of the circumventions under the European General Offer Rule, see generally Jeremy Grant et al., Financial Tunneling and the Mandatory Bid Rule, 10(2) EUR. BUS. ORG. L. REV. 233 (2009).
137 In Canadian Ontario, the threshold is 20%. Securities Act art. 89 (Ont.).
138 To be sure, this defect is not unique to the Partial Offer Rule. The General Offer Rule faces the same challenge to the extent that a numerical threshold is employed for determining whether a second-phase tender offer procedure should be initiated. Similarly, an acquirer subject to the General Offer Rule can circumvent this mandate and thus frustrate the purpose of the General Offer Rule if acquiring holding a below threshold amount of shares is enough for the acquirer to obtain the control over the target company. See Papadopoulos, supra note 54, at 527.
139 We note that some General Offer Rule countries instead adopt the substantial approach. For instance, Italy used to stipulate that an acquirer is required to launch a tender offer if it effects a change of control of a listed company. Italy, however, repealed this criterion, out of the concern that it proved vague in practice. See Grant et al., supra note 136, at 250. Spain, on the other hand, still maintains adopting the substantial approach by stipulating that if a party acquires shares of a Spanish company (but do not attain at least 30% of the voting rights therein) and, within the 24 months following that acquisition, appoint (or are deemed to have appointed) a majority of the company’s board members, it is obliged to launch a tender offer procedure. See Freshfields Bruckhaus Deringer, An Introduction to Public Takeovers in Spain, at 1-2, available at http://www.freshfields.com/uploadedFiles/siteWide/Knowledge/An%20introduction%20to%20public%20takeovers%20in%20Spain.pdf/. Some academic literatures also appear to advocate the substantial approach, see Andrews, supra note 2, at 547.
not work. It might be because the incumbent controlling shareholder holds too many shares that exceed the controlling threshold or because the target has other blockholders and thus to obtain the control requires for more shares. In these cases, the acquirer and the incumbent, who are doomed to be subject to the mandatory tender offer obligation, might consider another strategy to reduce the impact of the mandatory tender offer procedure to minimal.

One strategy the acquirer and incumbent may consider is the “small-leap” strategy: the acquirer may purchase shares from the incumbent through private transactions to an amount close to the numerical threshold in the first place and then initiates the tender offer procedure to purchase the remaining needed shares. For instance, if the numerical threshold is 30%, while the acquirer intends to purchase 32% of the target’s shares, she may privately purchase 29% of the target’s shares from the incumbent in the first place, then initiate the tender offer procedure to purchase the remaining 3%. Through this arrangement, in the tender offer procedure the acquirer only offers to purchase 3% instead of 32% of the target’s shares, and the incumbent may circumvent the pro rata purchase rule to the largest extent and sell most of her shares. Under this arrangement, minority shareholders become the losers since they share less the opportunity to sell their shares through mandatory tender offer. This arrangement further frustrates the spirit of the Partial Offer Rule since the more shares the incumbent gets to sell, the fewer shares she retains and the less she concerns the target’s future performance under the acquirer’s control. It defeats the filter mechanism of the Partial Offer Rule.

Countries adopting the Partial Offer Rule are well aware of this strategy and adopt different regulations to address it. One regulatory approach is a mandatory minimum tender offer amount. In China, for instance, acquirers are required to purchase at least 5% of shares through tender offer procedure. Therefore, in the above hypothetical case, even though the acquirer is allowed to purchase 29% of the target’s shares from the incumbent through private transaction in the first place, when it comes to the tender offer procedure, the acquirer is required to offer to purchase at least 5% of the target’s shares although she only wants to purchase 3%. By prescribing this mandatory minimum tender offer amount, Chinese laws indirectly force incumbents to retain some minimum amount of shares after the acquisition.

Another regulatory approach is to introduce an integrated approach that indirectly discourages the first-phase private transaction. Japan, for instance, requires acquirers to conduct all their

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140 For instance, if the incumbent controlling shareholder also holds 32% of the target’s shares, under the normal scenario, she only gets to sell 32% of them, that is, 10.24% of the target’s shares, which means that she has to hold 21.76% of the target’s shares. However, under this “small-leap” arrangement, she would sell 29% of her shares to the acquirer in the first place and may sell 0.1% in the tender offer procedure (i.e. 3% * 3/(100-29)), thus holding only 2.9% of the target’s shares after the acquisition. This arrangement obviously deteriorate the “skin in the play” effect of the Partial Offer Rule.

141 Unlike the “stay-below-the-surface” circumvention, this type of circumvention is unique to the Partial Offer Rule. Under the General Offer Rule, there is no need to adopt this strategy since once the acquirer’s holding exceeds the controlling threshold, she has to extend tender offer to all shareholders regardless how much she exceeds the threshold. The amount of shares obtained in the first-phase private control transaction has no bearing on the acquirer’s second-phase tender offer obligation.

142 Takeover Measure art. 25 (China).

143 While we praise this idea in general, we are skeptical of setting the floor as 5%. In the worst scenario, the incumbent will hold no more than 5% of the target’s shares after the acquisition. We are unsure if this can bring large enough “skin in the play” of the incumbent.
contemplated purchase of shares, be it a single transaction or multiple transactions, within no more than 6 months, through tender offer. Therefore, if an acquirer plans to acquire 29% of the target’s shares from the incumbent and, within 6 months, initiates a tender offer procedure to acquire the rest of 3% shares, under Japanese laws all these 32% of shares must be purchased through tender offer procedure in the first place. Any private purchase of the 29% of the target’s shares will thus constitute a violation. Accordingly, the “small-leap” strategy is indirectly prohibited if an acquirer fails to leave enough interval between the first-phase private acquisition and the second-phase tender offer. In response to this restriction, a smart acquirer can still circumvent the Partial Offer Rule by leaving long enough interval between her first-phase and second-phase acquisition. However, this will delay her completion of the acquisition, which imposes more cost of capital on the acquirer. Hence, while the Japanese integrated approach may not suffice to prevent all “small-leap” strategies from being employed, at least it increases the difficulty for acquirers and incumbents to circumvent the Partial Offer Rule.

There may be a third regulatory approach that goes perhaps further. In Taiwan, the current court practice appears to inquire substantially into the real “plan” of the acquirer and oblige the acquirer to purchase all the shares she “plans” to purchase through tender offer procedure: as long as the acquirer has an acquisition plan to acquire the target’s control, it does not matter if she implements her plan through a single transaction or multiple transactions or how long the interval between multiple transactions; these transactions altogether belong to an integral acquisition “plan.” In that sense, an acquirer cannot skip the mandatory tender offer procedure by artificially separating her acquisition plan into multiple transactions; instead, she must acquire all these shares through a single tender offer procedure. To be fair, while this inquiry into substance may prevent more circumvention cases, it is unclear how the court should determine whether two share purchase transactions belong to an integral control transaction “plan”. It could introduce considerable “grey areas” which pose difficulties on acquirers to comply with the Partial Offer Rule and lead to significant transaction uncertainty. To adopt this regulatory approach thus requires a long-term development in case laws.

c. “Price-cut” Strategy

The acquirer and the incumbent controlling shareholder may also frustrate the purpose of the Partial Offer Rule by cutting the tender offer price to that lower than the market price. In that case, minority shareholders will find the offer price unattractive and refuse to tender their shares, and the incumbent may then sell more its shares to the acquirer. Certainly, for this strategy to be adopted in practice, one important precondition having to be met is the incumbent’s consent. In normal courses, a rational and arms-length incumbent should be reluctant to accept a lower offer price, considering that she holds the most of the target’s shares and will suffer significant loss by a low tender offer price. However, in some special occasions, for instance, if the incumbent herself is under urgent needs to cash out her shares, or if the acquirer is an interested party to the incumbent, or if both parties agree on some under-table payment, the incumbent might be

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144 Financial Instruments and Exchange Act art. 27-2(1)(iv) (Japan).
145 In contrast, if an acquirer’s plan is to acquire 29% in the first place and, after 7 months, acquire the rest of 3%, since these two transactions do not occur within 6 months, she only needs to offer 3% instead of 32%.
146 See Taiwan High Court Nov. 27, 2013, 99 Jin-Shang-Zhong-Su No. 61 (Taiwan).
147 Specifically when the regulator fails to capture the use of the above “small-leap” strategies, the acquirer and incumbent can arrange a private transaction with a higher acquisition price in the first place then initiate the mandatory
willing to accept a low tender offer price. Therefore, we cannot rule out the possible use of this “price-cut” strategy as well.\(^{148}\)

One regulatory approach often employed by the General Offer Rule camp is setting some statutory floor limits to the tender offer price.\(^{149}\) In the Partial Offer Rule camp, tender offer price limit is relatively rare but still present. China, for instance, requires the tender offer price to be no less than the highest price that the acquirer paid for purchasing the target’s shares within 6 months before the announcement of the tender offer.\(^ {150}\) Canadian Ontario similarly requires the tender offer price to be no less than the price paid by the acquirer for purchasing the target’s shares within 90 days in advance of the bid.\(^ {151}\) This regulatory approach, however, calls for some caution since a price limit might risk distorting the price mechanism in the market and thus compromising the efficiency. Specifically for markets with more fluctuated stock price, the statutory floor limit may fail to reflect the true price of the target and therefore discourage potential control transactions.

**B. Circumvention Through Interference in Rule-making**

In their implementation, all mandatory bid rules, be it the General Offer Rule or the Partial Offer Rule,\(^ {152}\) are not golden rules without exception. Often times regulatory or policy needs call for some exemption. However, this also creates a room for interested parties who benefit from under-regulation to maneuver the events of exemption to fit their purpose.

*a. Some Justified Events of Exemption*

There are sound reasons to exempt some control transactions from being subject to the Partial Offer Rule. These reasons can range from avoiding rigid application of the Partial Offer Rule to the pursuit of other conflicted policy objectives.

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\(^ {148}\) We admit that some of these occasions may have involved the breach of the incumbent controlling shareholder’s fiduciary duty. However, since many countries lack a robust enforcement system as mentioned above, a breach of fiduciary duty does not mean that such behaviors will not be tolerated. Besides, sometimes it is challenging for other minority shareholders to establish the case of a breach of fiduciary duty.\(^ {149}\) Price limit is quite common in countries implementing the General Offer Rule since there the tender offer takes place immediately after an acquirer purchases controlling blocks from the incumbent and, without an offer price limit, minority shareholders might feel coerced to sell their shares in the second-phase tender offer. For the introduction of the price limit in European countries, *see generally* CMS Cameron McKenna LLP, *supra* note 58. To be sure, one should caution against generalizing the experience of the General Offer Rule camp to the Partial Offer Rule camp since both regimes are quite fundamentally different: the mandatory tender offer here does not take place after the control transfer is done; it is instead the process of control transfer. Rather than ensuring the undistorted mind of minority shareholders after the acquisition, the price limit under the Partial Offer Rule, if needed, is concerned with the undistorted mind of minority shareholders before the acquisition. Nevertheless, to the extent both regimes employ a sharing vehicle to filter out inefficient transactions from efficient ones, one might ask if the Partial Offer Rule camp should introduce similar tender offer price limit.\(^ {150}\) Takeover Measure art. 35 (China).\(^ {151}\) Securities Act art. 93.2(1) (Ont.).\(^ {152}\) For the introduction of the events of exemption in European countries, *see generally* CMS Cameron McKenna LLP, *supra* note 58.
One major type of events of exemption aims at fine-tuning the Partial Offer Rule in order to prevent the Rule’s rigid applications. As mentioned above, the Partial Offer Rule is designed for regulating control transactions, while the definition of control transactions can be far from perfect. For countries which define control transactions by a specified numerical threshold, they also acknowledge the possibility of over-regulation as elaborated above. To address that problem, rule-makers may stipulate certain cases that reach the numerical threshold but in effect do not involve control transaction as exempted transactions and exempt them from being subject to the Partial Offer Rule. For example, in China, which defines control threshold as holding 30% of the target’s issued shares, the events of exemption contain cases where the acquisition does not lead to the change of substantial controller. They also contain cases where the acquirer has already held more than 50% of the target’s shares before the acquisition, since in that case the acquirer has definitely obtained the control over the target and her future purchase of shares no longer constitutes a control transaction in need of the Partial Offer Rule’s control. To that extent, the events of exemption are soundly justified.

Another major type of events of exemption concern the harmonization with other policy considerations. One instance relates to the Partial Offer Rule’s potential conflict with the family laws. For instance, if the incumbent controlling shareholder dies and her heir inherits her controlling block of shares, formally speaking it also involves a transfer of control from the incumbent to the heir. There is a similar normative concern that the heir might be an inefficient controller to which the Partial Offer Rule should be applied. However, applying the Partial Offer Rule to that case will certainly deprive the heir’s entitlement to the estate and defeat the integrity of inheritance laws. It is also meaningless since the incumbent is not there and the Partial Offer Rule’s designed “skin in the play” has no subject to attach to. Accordingly, the balance of interest between various policy objectives should warrant the exemption of such transfer of control event from the Partial Offer Rule.

One can imagine that statutes and rules can hardly capture all sources of over-regulation and conflicting policy concerns. Acknowledging the ex ante incompleteness of rule-making, some countries adopt a rather ex post approach by vesting the securities regulators with blank discretion in examining whether an individual case deserves an exemption on a case-by-case basis. For instance, in China, the Chinese Securities Regulatory Commission (“CSRC”) is vested with the discretion to exempt a mandatory tender offer for the purpose of “accommodating the development of and variation in the securities market and protecting the investors’ legitimate interest.” To the extent that the regulator’s such discretionary power is exercised in fair and equitable manner, this delegation approach is justifiable. The problem, however, is always about how to ensure that the regulator’s such power is not misused.

\[b. \text{Some Controversial Events of Exemption}\]

In contrast with the above justifiable events of exemption, here we illustrate several real-world events of exemption which are rather controversial. To be fair, many of them originally bear

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153 Takeover Measure art. 62(1)(i) (China).
154 E.g., Takeover Measure art. 63(1)(iii) (China).
155 The events of exemption under Chinese laws, for instance, contain the inheritance. Takeover Measure art. 63(1)(vi) (China).
156 Takeover Measure arts. 62(1)(iv) & 63(1)(vii) (China).
sound rationales, but they also provide some regulatory loopholes for acquirers and incumbent controlling shareholders to circumvent the spirit of the Partial Offer Rule.

i. Market Purchase Exemption in Japan

Japan has a controversial event of exemption named the “market purchase exemption.” Under Japanese laws, the Partial Offer Rule and the mandatory tender offer procedure only apply to purchase of shares that are “conducted outside of Financial Instruments Exchange Markets”.\(^{157}\)

Therefore, even if an acquirer plans to purchase more than one-third of the target’s shares, which has exceeded the statutory threshold, she is not obliged to initiate a tender offer procedure to perform her plan if she purchases these shares in the public securities market. Only when she acquires the shares through private transaction will she be subject to the mandatory tender offer obligation. In addition to Japan, South Korea also adopts a similar market purchase exemption.\(^{158}\)

China and Taiwan, in contrast, do not open this gate.

The rationale behind this market purchase exemption relates to a somewhat different perception in Japan (and in South Korea) of the Partial Offer Rule. In Japan, for instance, it is argued that Japan’s Partial Offer Rule concerns less the protection of minority shareholders than the pursuit of transparency of corporate control transactions and the fair distribution of control premium. And this market purchase exemption simply reflects this belief.\(^{159}\)

To the extent that acquirers conduct their acquisition plan through the public securities market, the market is able to absorb and then circulate acquisition-related information to all market participants, including the target’s other non-controlling shareholders, and accord them adequate protection. To that extent, these non-controlling shareholders do not need a mandatory tender offer procedure in order to have access to the acquisition-related information through prospectus; the market is able to reflect it. Moreover, since the acquisition is conducted in the public securities markets, these non-controlling shareholders will have equal opportunity to sell their shares to the acquirer with equal price and terms and thereby share the control premium with the incumbent controlling shareholder. A mandatory tender offer procedure which is both time-consuming and costly thus can be unnecessary. To some extent, this rationale appears to aim at preventing a rigid application of the Partial Offer Rule, which could be a justified one.\(^{160}\)

Despite the above sound rationales, the market purchase exemption risks creating a loophole for acquirers and incumbent controlling shareholders to circumvent the spirit of the Partial Offer Rule. On its face, acquirers and incumbents can hardly conduct their control transaction in the public securities market since trade of shares in the public market is not face-to-face transaction. Rather, it takes place anonymously, and when the acquirer offers to purchase the target’s shares at a specific price in the public market, presumably all the target’s shareholders should have equal opportunity with the incumbent to accept the offer and sell their shares. Therefore, one might expect that a control transaction conducted in the public market is not exclusive to the acquirer and incumbent, and thus other non-controlling shareholders can equally share the premium just as the case in the mandatory tender offer procedure. In practice, however, it is possible for acquirers

\(^{157}\) Financial Instruments and Exchange Act art. 27-2(1)(ii) (Japan).

\(^{158}\) Financial Investment Business and Capital Markets Act art. 133.3 (S. Kor.), Enforcement Decree of the Financial Investment Services and Capital Markets Act arts. 140.1 & 140.2 (S. Kor.).

\(^{159}\) Fujita, supra note 7, at 31-33.

\(^{160}\) For some justification for this market purchase exemption, see Andrews, supra note 2, at 546-47.
and incumbents to make a control transaction in the public market private. Note that unlike tender offer procedure, in which there is a specified tender offer period, which can last for weeks, for all shareholders to tender their shares, trade in public securities market is matched in second. Therefore, other non-controlling shareholders’ equal opportunity to join the control transaction, if any, is in only a second. Once that critical moment passes, this opportunity vanishes. In light of this feature of public securities market, if acquirers and incumbents do not wish other non-controlling shareholders to participate in their control transaction, they can have a private deal confirming all the price and terms beforehand, then “time” the moment to make their respective offer and acceptance in the public market. Through the assistance of sophisticated brokers and dealers, the incumbent can immediately accept the offer made by the acquirer, or vice versa, leaving no time for other non-controlling shareholders to join the deal. Through that arrangement, the market purchase exemption could become a loophole of Japan’s Partial Offer Rule.161

ii. Share swap Exemption in Taiwan

Taiwan also has a special but controversial event of exemption related to share swap transactions. In practice, the consideration paid by the acquirer to acquire the target’s control is not exclusive to cash; other asset, in particular the stock issued by the acquirer, can do as well. Share swap in the context of control transaction then refers to a control transaction under which the acquirer issues its shares in exchange of the incumbent’s controlling block of the target’s shares. After the transaction completes, the incumbent will hold the acquirer’s newly-issued shares, while the acquirer will hold the target’s controlling block of shares. In Taiwan, while a cash control transaction is subject to the Partial Offer Rule, a share swap control transaction can be exempted.162 Therefore, if an acquirer and the incumbent do not wish to be restrained by the Partial Offer Rule, they can structure their control transaction as a share swap deal and therefore proceed with it without triggering the tender offer obligation.

The rationale behind the share swap exemption is a fear of compromising the purpose of share swap. Share swap can result in a cross-shareholding relation between the acquirer and the incumbent controlling shareholder, under which not only the acquirer holds controlling block of shares of the target, but also the incumbent holds some shares of the acquirer. If an acquirer wishes to not only obtain the control over the target, but also establish a strategic alliance with the incumbent (for, for instance, taking advantage of the incumbent’s connection, expertise or fund), share swap may be a good transaction structure to form this cooperative relation. However, if a share swap control transaction is subject to the Partial Offer Rule, a large portion of the new shares issued by the acquirer will flow instead to the target’s non-controlling shareholders, while the incumbent may receive fewer. This might frustrate the establishment of a strategic alliance between the acquirer and the incumbent. To some extent, this event of exemption aims at harmonizing the purpose of the Partial Offer Rule with other policy considerations, which could

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161 To address this loophole, South Korea’s narrower definition of its market purchase exemption may be of reference value. According to South Korean laws, the Partial Offer Rule only applies to control transactions conducted outside of the stock market, and a negotiated acquisition of shares under an agreement between the seller and the buyer on the item, price and number of the shares can be deemed to have been conducted outside of the stock market. Moreover, even if the execution and clearance of the share transaction takes place in the stock market, the Partial Offer Rule still applies. See Enforcement Decree of the Financial Investment Services and Capital Markets Act art. 144 (S. Kor.).

162 Tender Offer Regulation art. 11(2)(v) (Taiwan).
be justifiable in theory.

Nevertheless, a number of arguments may challenge the share swap exemption. First of all, not all share swap deals aim at building strategic alliances. In many cases, an acquirer engaging in share swap in fact has no plan of strategic alliance. She chooses share swap simply because she is cash-deficient: by conducting a share swap, she does not need to raise cash or incur debts to pay for the acquisition, which alleviates her capital or liquidity pressure. The strategic alliance concern does not exist in such cases. Exempting these share swap transaction from the Partial Offer Rule is simply meritless. It further discriminates against cash transaction and implicitly encourages acquirers to opt for share swap deal instead of cash deal, which will distort acquirers’ rational decisions and incur efficiency loss. Besides, even if an acquirer contemplates a strategic alliance, subjecting share swap transaction to the Partial Offer Rule has no practicability issue. For instance, it has been raised that an acquirer subject to the Partial Offer Rule but wishing to form a strategic alliance with the incumbent can pay other non-controlling shareholders in cash equivalent to the value of the share consideration while engage in share swap with the incumbent controlling shareholder. In light of the above, the share swap exemption implemented in Taiwan might call for more contemplation.

iii. State-owned Enterprise Exemption in China

China has a different controversial event of exemption which favors Chinese state-owned enterprises (“SOEs”). In China, if a free transfer, changes or merger of state-owned assets approved by the government or the state-owned asset management authority causes an investor to hold more than 30% of the target’s issued shares, the parties may file for exemption from the CSRC. Besides, as mentioned above, the CSRC also has inherent discretion to approve the exemption of an individual case. Coupled with the CSRC’s long friendly attitude toward Chinese SOEs, these exemptions are often permitted easily to the control transactions between SOEs, while private enterprises are subject to stricter mandatory tender offer rule. Non-controlling shareholders of listed Chinese SOEs, therefore, are subject to less protection. The rationale behind the SOEs exemption is to facilitate the restructuring of Chinese SOEs as well as to prevent the reduction of state-owned assets. Chinese SOEs still play an extremely influential role in Chinese economy, which is a crucial vehicle for Chinese party state to maneuver economic development and exercise political control of the society.

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163 To be sure, share swap still incurs some side effect: since the acquirer needs to issue new shares to pay for the acquisition, she might risk diluting her shareholders’ shareholding and introducing the incumbent controlling shareholder to become her blockholder.

164 Andrews, for instance, argued that share swap should not serve an excuse for exemption. For his detailed analysis, see Andrews, supra note 2, at 549-50.

165 Takeover Measure art. 63(1)(i) (China).

166 Weng, supra note 7, at 200-01, 209-10.

167 It has been reported that, even after 35 years of economic reforms since 1978, it is estimated that the share of GDP owned and controlled by the state and SOEs remain approximately 50% as of the end of 2011. Andrew Szamosszegi & Cole Kyle, An Analysis of State-owned Enterprise and State Capitalism in China (U.S.-China Economic and Security Review Commission, 2011), at 1.

168 For an introduction to the role of Chinese SOEs in Chinese society and how the party state exercises its power, see generally Li-Wen Lin, State Ownership and Corporate Governance in China: An Executive Career Approach, 2013 COL. BUS. L. REV. 743 (2013); Li-Wen Lin & Curtis J. Milhaupt, We are the (National) Champions: Understanding
Notwithstanding the continuous appeal for SOEs reform, Chinese party state so far is reluctant to relinquish its control over SOEs.\textsuperscript{169} At the meantime, restructuring Chinese SOEs, in particular consolidating those SOEs engaging in similar businesses, in order to enhance their overall operational efficiency is increasingly needed.\textsuperscript{170} To respond to that demand, control transaction could be a way to restructure under-performing SOEs, but the Chinese party state definitely does not want other non-controlling shareholders to involve in the control transfer and complicate the restructuring process. By virtue of the SOEs exemption, SOEs and state-owned asset management authorities may find a way out from the Partial Offer Rule. Moreover, since control transactions between SOEs is under the maneuver of the Chinese party state’s “visible hand” as opposed to the market’s invisible hand, which in any event result in a state controller that, under Chinese legal regimes, is presumed to be “benevolent,” the need to apply the Partial Offer Rule to introduce market discipline for promoting efficient transaction also diminishes. Hence, to the extent that the SOEs exemption reflects the priority of SOEs restructuring over the Partial Offer Rule’s spirit in the Chinese context, it might be justifiable.

The justification for SOEs exemption depends largely on the Chinese party state’s benevolence, though. To some degree, the SOEs exemption represents an epitome of the Chinese-style corporate governance, under which the state plays a major role in intervening in corporate decisions.\textsuperscript{171} In many occasions, the Chinese party state’s judgment replaces private ordering in allocating resources of the Chinese economy: like here, whether a control transaction is efficiency-increasing enough to go is determined by the government, not related market players. To the extent that the Chinese party state can correctly determine which governmental entity or state-asset management authority is a more efficient controller of a given SOE, this state-dominated model may do less harm than what market capitalists predict. Nevertheless, the core question is how to ensure that the party state’s judgment is superior to the market’s ordering. Perhaps the party state has superior knowledge of the needs of Chinese economy, politics and society, which enables it to put a given SOE to the hand of a more appropriate agency. However, as more non-economic factors penetrate in the decision-making process, one can hardly tell if the party state’s decision is for the good of the society’s public interest or merely for the good of the party’s private interest. As SOEs reforms in China is heading toward an increasingly marketized path, perhaps at some point China might want to revisit the role of the party state vis-à-vis the market in corporate governance, including in control transactions regime and the SOEs exemption here.

C. Summary

In sum, the Partial Offer Rule in the real world is not as rosy as that in theory. Market players could innovate many ways to circumvent the rule, and a country’s political economy might further

\textsuperscript{170} Id.
\textsuperscript{171} Id. and this Chinese-style corporate governance is in turn an epitome of the Chinese-style state capitalism. For some introduction to this Chinese-style state capitalism, see e.g., RONALD COASE & NING WANG, HOW CHINA BECAME CAPITALIST (2013); Michael A. Witt & Gordon Redding, \textit{China: Authoritarian Capitalism, in The Oxford Handbook of Asian Business System} (Michael A. Witt & Gordon Redding eds., 2013). YIFU LIN (林毅夫), JIEDOU ZHONGGUO JINGJI (解读中国经济) \textit{DEMYSTIFYING THE CHINESE ECONOMY} (2012); YASHENG HUANG, CAPITALISM WITH CHINESE CHARACTERISTICS: ENTREPRENEURSHIP AND THE STATE (2008).
enhance the circumvention to a rule-making level. This again proves that the devil always hide in the details.

V. CONCLUDING REMARK

Through this paper, we contribute to current comparative studies of control transaction regimes by elaborating more the Partial Offer Rule, a middle way of control transaction regime widely implemented in East Asian countries, including Japan, South Korea, China and Taiwan. By introducing the cost of fund factor into the economic analysis framework, we demonstrate that among the mandatory bid camp, the Partial Offer Rule, compared with the General Offer Rule as adopted in EU countries, is more efficient and thus should be more representative. We also compare the filter function of the three regimes and argue that the incumbent controlling shareholder filter as employed by the Partial Offer Rule is more robust. In sum, we illustrate from a theoretical perspective the merits of the Partial Offer Rule.

Having said so, at this moment we hesitate to claim the superiority of the Partial Offer Rule. We wish to highlight a very fundamental assumption of our analyses throughout this paper, that is, the presence of an incumbent controlling shareholder. According to our reasoning, the theoretical charm of the Partial Offer Rule consists of the “skin in the play” of the incumbent controlling shareholder. This, however, requires the presence of an incumbent. If the target’s shareholding structure is dispersed and lacks an incumbent, the merits of the Partial Offer Rule we claim in this paper will be limited. In that case, the Partial Offer Rule is nothing more than providing an equal opportunity for all shareholders to share the target’s control premium, but now we find little justification to explain the efficiency functionality of allowing a statutory intervention to have all shareholders share the control premium. Following that line, the desirability of the Partial Offer Rule might be less solid in countries whose companies’ shareholding structure is mostly dispersed, such as the U.S. and the UK. From this ownership structure perspective, perhaps one may find explanation of why these two countries do not adopt the Partial Offer Rule but each becomes the leader of the Market Rule camp and the General Offer Rule camp. In sum, the one-size-cannot-fit-all problem still exists.

Finally, which specific control transaction regime a country adopts may also involve that country’s political economy. For instance, the political economy behind the EU countries that led to the introduction of the General Offer Rule into the Takeover Directive which do not necessarily fit the functionality needs of many EU countries has been well-illustrated. Similar issues can also exist in the Partial Offer Rule camp. One may observe this from those controversial events of exemption as mentioned above: their compromise of the spirit of the Partial Offer Rule could be a product of a given country’s political economy. For instance, the SOEs

172 Ventoruzzo, for instance, argued that for widespread ownership structure, mandatory bid rule is more about preventing the birth of a large block-holder who may weaken the potential discipline of the market that is uneasy to reverse, while for concentrated ownership structure the mandatory bid rule helps the controlling shareholder to fend off an undesired suitor. Ventoruzzo, supra note 2, at 140, 168-172. In contrast, for arguments suggesting that ownership structure plays little rule in the formulation of particular acquisition of control rules, see Magnuson, supra note 2, at 234-35.

173 Magnuson, for instance, argue that the difference in acquisition of control rules between U.S. and EU is due to the difference in law formulation process and institutional competency: the rule-maker in the U.S. is the court while that in EU is the political actors. See generally Magnuson, supra note 2.

174 See generally Ventoruzzo, supra note 2.
exemption in China as mentioned above might result from the political influence of Chinese SOEs’ managers and the party state’s economic planners. The market purchase exemption in Japan and the share swap exemption in Taiwan might also result from the political influence of related interest groups in these countries, such as those comprised of incumbent controlling shareholders. The political factors behind the Partial Offer Rule camp should be worth further exploration. In conclusion, we believe the Partial Offer Rule deserving more specific attention from comparative studies, and we anticipate this paper serving a kick-off.