

Study on Directors' Discretion in Takeover: A Perspective of Rebalancing Directors' Takeover Discretionary Power

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Abstract: The research object of this study is the discretionary decision-making power of directors in corporate acquisitions. The main research jurisdiction is the United Kingdom, and the main research purpose is to analyse whether more discretion should be given to directors in acquisition decisions. Corporate takeover behaviour is divided into friendly takeover and hostile takeover according to the attitude of the target company. In a friendly takeover, the acquirer and the target reach an agreement and the acquisition process proceeds smoothly. In a hostile takeover, when the target company is not willing to be acquired, the acquiring company can directly contact the shareholders beyond the company's management of the target company to make the acquisition. To defend such takeovers, corporate directors can often take some anti-takeover measures to fend off takeovers. This study divides the decision-making power of directors in takeovers into whether directors can take anti-takeover measures to resist hostile takeovers and thus affect the outcome of takeovers. The UK takeover regulation is set up with shareholders as the center, so the UK company directors often do not have much decision-making power in takeovers. This study will analyse the current anti-takeover measures in the UK and study the feasibility of giving more discretionary power to directors.

1. Introduction

This article discusses power distribution between directors and shareholders in hostile takeovers. Corporate takeovers are classified as friendly or hostile based on the attitude of the target company's directors towards the offer.

[A] hostile takeover occurs when an acquiring company, commonly referred to as a raider, directly makes a tender offer to the shareholders of a target company without seeking approval from the incumbent management. In this scenario, shareholders independently decide whether to tender their shares. On the other hand, a friendly takeover requires approval from both the shareholders and the management of the target company.^[1]

The discretion under discussion is the deciding power in takeover defence of hostile takeovers. Two opposing views exist on this matter. One side supports granting directors more power, which gives them more autonomy in using takeover defence measures. The other side believes that the board of directors' power should be restricted, and the discretion to decide the company's takeover should

be entrusted to the board of shareholders. This article takes a balanced approach and, while adhering to the current shareholder-centric position in the UK, slightly relaxes the restriction on director's power in takeovers. This approach grants director autonomy while introducing the business judgment rule to balance protecting shareholders' interests and promoting an active acquisition market.

2. Background of Anti-Takeover Measures

Takeover defence measures can be divided into three categories, depending on the board of directors' authority and whether shareholder approval is required.^[2]

In a friendly takeover, an agreement is reached between the target company's directors and the bidder. After the target company's directors have readily accepted the offer and the shareholders have voted to approve it, the takeover is officially launched. Joseph mentioned that "in most friendly takeovers, the role of directors is to act as a bridge between the bidding firm and the acquired firm."^[3] The directors of the target company mainly consider the market value and make the transaction follow the contract law. Therefore, the discretion of directors is difficult to be reflected. In a hostile takeover, the target company's directors refuse to accept the offer. However, the bidding company can bypass the directors and deal directly with the target company's shareholders. In such a case, the directors may counter the takeover by taking anti-takeover measures. It can be seen that whether to take takeover defence measures becomes an important factor in determining the hostile takeover outcome. The director's discretion discussed in this article focuses on whether directors should do more to counter hostile takeovers.

The basis of takeover defence regulation is the conflict of interest between shareholders and directors. "Modern company law uses a board-centric statutory governance structure where the board of directors is given the power by company law to take overall responsibility for the management and operation of the company's business."^[4] However, this power can only be exercised for the company's benefit and not for the directors' benefit. Some directors conduct anti-takeover measures for their interests, leading to conflict between shareholders and directors. Therefore, the anti-takeover measures need to be regulated. At the same time, it is necessary to specify standards to evaluate the rationality of directors' anti-takeover behaviours.

3. A Comparison of Anti-takeover Regulatory Strategies between the UK and US

When facing hostile takeovers, takeover defence measures require appropriate regulatory tools because it can lead to conflicts of interest between directors and the company. The UK takeover regime for listed companies is based on shareholder centrism, while the cornerstone of the US regime is board centrism to uphold the power of the company's management. The fundamental difference between the takeover regimes of the two countries lies precisely in this difference in philosophy.

"In the UK, the core philosophy of takeover regulation is "shareholder sovereignty", where shareholders determine the outcome of a takeover bid, and the target company's directors cannot deny them the opportunity to do so."^[5] Therefore, the target company's directors have only limited means to influence the outcome of a takeover bid. "Under Rule 21 of the UK Takeover Code, when a takeover bid occurs, management in the UK must not take any action to frustrate the offer without the consent of shareholders."^[6] This rule is also known as the No Frustration Principle, and the Board of Directors shall abide by the "no frustration principle" and leave the decision to counter the offer to the General Meeting. The Board of Directors cannot take takeover defence measures without the approval of the shareholders' meeting. "Under the Takeover Code, when a shareholder carries 30% or more, it is forced to make an open offer to all shareholders of similar shares of the target company."^[7] This rule protects the interests of minority shareholders by protecting all shareholders who can sell their shares and get a control premium in company acquisition. At the same time, the

rule restricts the hostile takeover of more than 30% of the shares, which objectively plays a certain anti-takeover effect.

In the US, the acquirer of a listed company enjoys complete freedom in acquiring shares of the target company's stock. The law also allows the target company's management to use various corporate takeover defences in response to a takeover bid, the most typical of which is the so-called "poison pill plan". In the US, the management of a company with a poison pill plan and a cross-board of directors has almost complete discretion to resist a takeover bid that is less than desirable.

3.1 Compare Proper Purpose Doctrine and Business Judgment Rule

The regulation of anti-takeover measures in the UK is derived from company law. "Under company law, a director of a company must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred."^[8] The duty of loyalty of directors stipulated by this legislation is the basis of the proper purpose doctrine. "The UK courts utilised the proper purposes doctrine to examine takeover defences and provide a negative answer to directors' imposition of anti-takeover measures."^[9] It is aim to regulate the interest conflicts between directors and shareholders in the context of anti-takeover, excluding the autonomous adoption of takeover defence measures from the directors' powers of operation. This power has been given to the shareholders' association in the City Code. As a result, in the UK, anti-takeover behaviour by companies that would usually be considered to have mixed motives may offend this provision.

The US courts have developed a rule of case law on the duty of care of directors, the business judgment rule. The courts first assume that a director's conduct meets this standard, and if the plaintiff believes that the director's behaviour does not meet this standard, the burden of proof must be on. In the 1964 case of *Cheff.v. Mathes* in the Delaware Court of Chancery, the court was careful to apply this rule to anti-takeover.

[T]he courts held that directors could be excused from liability if they could prove that their decision was for the benefit of the company or its shareholders and not for their benefit and that the decision was made after careful investigation and deliberation and was a sound business judgment.^[10]

This decision has been reinforced and widely applied in subsequent jurisprudence. The purpose of the business judgement rule is to prevent directors from being overly cautious in dealing with a company's business. Directors may be too intimidated by the pressures of duty of care. This rule gives directors appropriate reasons to lower the standard of directors' duty of care, encouraging directors to act proactively to promote long-term corporate growth and business innovation.

3.2 Evaluation of the Anti-takeover Regulatory Strategies in the UK and US

"The essence of the UK model is that it grants the right to take an anti-takeover bid to the target company's shareholders, with the practical effect of limiting anti-takeover measures."^[11] In practice, the anti-takeover approach to regulation has worked well in the UK. It has successfully dealt with parties' conflicting interests in corporate takeovers, allowing them to develop along a healthy trajectory. As a result, there is little controversy in theoretical and practical circles. The essence of the US model is to give the target company's management broad powers to take anti-takeover measures. "US managers' measures are only restricted by the flexible business judgment rule, as described in the case of *Unocal Corp. v. Mesa Petroleum Co.*"^[12] They have greater freedom than their counterparts in the UK to employ defensive measures.

4. Reasonableness of Adherence to Shareholders' Meeting Centrism

This article argues that there is a theoretical and practical basis for the UK to uphold shareholder

centrism and to continue to vest the power to make takeover decisions in the shareholders' meeting rather than the board of directors.

The UK's "shareholders meeting decision mode" results from the traditional corporate governance structure of "shareholders' meeting centralism". In this corporate governance structure, the general meeting of shareholders is the highest "omnipotent organ" among all organs of the company.^[13]

The general meeting of shareholders decides all matters relating to the company's operation. At the same time, the board of directors is merely the executive organ of the resolution of the general meeting of shareholders. As a result, the right to decide on an anti-takeover bid is, as a matter of course, exercised by the general meeting of shareholders.

In addition to the theoretical basis, the prevalence of institutional investors in the UK provides a practical basis for shareholder meetings to decide on takeovers. "Since the end of World War II, institutional investors have grown to replace individual investors as the mainstay of the market."^[14] Institutional investors, as collective organisations, tend to own more company shares than individual investors. "They can use their significant ownership stakes to influence corporate governance practices and advocate for changes that align with their interests."^[15] In that case, conflicts of interest between directors and shareholders will be more likely to occur. This will significantly increase agent costs and have an impact on the UK capital market. Therefore, after considering the UK capital environment, this article argues that the UK should adhere to shareholder meeting centrism, but the need exists to give directors more autonomy in corporate takeovers.

5. Justification of Appropriate Granting of Power to Directors in Anti-takeover

Whether corporate takeover defence measures conflict with a director's fiduciary duties is based on a value judgement of the anti-takeover. The hostile takeover may not be justified, although it may generate premium income for shareholders of the target company. "The target company's board of directors may believe that a hostile offeror's offer undervalues the stock."^[16] Because shareholders do not have the information or ability to value the stock correctly, the board must negotiate and bargain with the acquirer on behalf of the shareholders and use takeover defence measures to force the acquirer to the bargaining table. As takeover defence measures increase the cost of the acquirer forcing control of the company by bypassing the board of directors of the target company, they can enhance the bargaining advantage of target company's directors. It can also facilitate the board of directors of the target company in securing a more reasonable transfer price for the shareholders, resulting in more significant equity for the shareholders. As the takeover defence measure have a certain degree of reasonableness, it cannot be assumed that a director is necessarily in breach of his fiduciary duty simply by taking or recommending anti-takeover measures. Whether a director breaches a fiduciary duty needs to be judged case-by-case. This article, therefore, proposes the introduction of a business judgment rule, combined with the current UK proper purpose rule, to assess the reasonableness of directors' anti-takeover behaviour.

On the other hand, market competition, technological progress, and the complexity of business transactions have put forward higher professional requirements for corporate management. The board of directors of a company is usually composed of professional managers and professionals as well as shareholders' representatives who are good at operation and management. As the result, the board centre can better adapt to the requirements of professional and efficient management of modern companies than the shareholders' meeting centre.

6. Introduction of Business Judgment Rule in UK Anti-Takeover

"Company law scholars argue that there are four basic categories of interest conflict matters. Anti-takeover behaviour is often considered to be corporate behaviour with mixed motives."^[17] In this type

of corporate behaviour, the directors are not directly involved but may have an indirect interest in the company's behaviours. "Some scholar describes that although the directors must claim that the anti-takeover measures are for the benefit of the company and its shareholders, the directors may only want to keep their positions and related benefits."^[18] If the director takes anti-takeover measures purely to protect his job, then it is obviously in violation of the director's fiduciary duty. Therefore, the directors often take the low purchase price, the poor performance of the offeror, the unfair offer to shareholders or creditors, and the unfavourable realisation of the company's long-term goals as the reasons for anti-takeover. However, these arguments may be reasonable when directors truly consider the company's interests first. In such an environment, this article proposes to introduce the judgment criteria of the business judgment rule to help measure the justification of directors for implementing anti-takeover measures.

The key to reforming the rules lies in the restrictions of the authorisation of directors. This limit should draw lessons from the United States and be limited by the business judgment rule. It requires the directors to limit decisions on anti-takeover measures between maintaining the normal operations of the company and maximising the interests of shareholders. At the same time, it combines the business judgment rule and the director's duty of loyalty and care to judge whether the director's behaviour is reasonable. The current UK judicial practice tends to use directors' loyalty and duty of care to judge the rationality of directors' anti-takeover behaviour. The proper purpose rule is a basis for objecting to directors carrying out anti-takeover procedures. But as discussed above, any reasonable act of running the company by a director may have a dual purpose and partly self-interest in mind. It is too arbitrary to make a blanket judgment based only on the duty of loyalty and care stipulated in the company law. Therefore, in the face of hostile takeovers, directors should be given appropriate autonomy to take anti-takeover measures. At the same time, it will be more efficient to combine business judgment rule with proper purpose doctrine to judge the reasonable legality of directors' behaviours. Such a judgment rule would free up directors' powers and allow them to be bolder in applying anti-takeover measures in the face of a hostile takeover.

7. Conclusion

By comparing UK and US regulations on antitakeover conduct in corporate takeovers, this article expresses a view that the UK should maintain the shareholder sovereignty basis in antitakeover regulation while giving some discretion to directors. Overall, the current UK shareholder-centric rules on anti-takeover decision-making powers are working effectively; therefore, no overhaul is necessary. Maintaining shareholder centrism and leaving takeover decisions to the shareholders' meeting is efficient and sensible. However, it is essential to note directors' positive value and role in corporate takeovers. This article argues that the UK takeover rules should appropriately introduce the business judgment rule. In order to appropriately untie the restrictions on directors' powers in takeovers, the introduction of the business judgment rule in conjunction with the existing, proper purpose rule will enhance the effectiveness of the UK's anti-takeover standard for directors, which will strike a balance in the legal system and make the UK takeover market more dynamic.

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