University of Zurich[UZH]

Institute of Law

Takeovers and Mergers

Principles of Corporate Law / Gesellschaftsrecht (Master) – Lecture 12

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Main Points

- Takeover bids
- Takeover defenses
- Poison pills
- Board neutrality rule
- Breakthrough rule
- Mandatory bid rule
- Opting-out clause
- Squeeze-out right
- Sell-out right
- Mergers
- Inverse mergers

Takeovers *versus* Mergers

- Takeover = Acquisition of target company by acquirer without prior consent
  - Hostile *versus* friendly takeover
    - Hostile takeover: Saint-Gobain SA (France) – Sika AG (Switzerland)
    - Failed hostile takeover: Valeant Pharmaceuticals International Inc. (US) – Allergan Inc. (US) ($54 billion deal, i.e. $179 per share)
    - Friendly → BoD is in favor of acquisition when becoming aware
  - Target company may still exist as an independent legal entity controlled by the acquirer
- Merger = contractually agreed amalgamation of two or more companies into one single company without liquidation
  - Voluntary
    - Actavis PLC (Ireland) – Allergan Inc. (US) ($66 billion deal completed in March 2015, i.e. $219 per share) → Allergan PLC (Ireland)
  - Merger by consolidation / by absorption

Interplay of Different Regimes

- Securities regulation
  - Protection of public investors (shareholders of acquirer or target)
  - Fairness supports efficient and transparent markets

- Company law
  - Duties of directors to company, shareholders (and other stakeholders)
  - Rights of shareholders

- Competition/antitrust law
  - Promotion/Protection of competition
  - Example for intervention criterion:
    Restriction of concentrations that would likely "substantially lessen competition or […] create a monopoly" (Section 7 U.S. Clayton Act)

Excursus: Necessity for other thresholds especially in the "digital economy"?

- Annual (total and domestic) turnover thresholds
- e.g. Apple acquires a company every 2-3 weeks;
  Google acquired over 260 companies in the last twenty years
- "Data thresholds"? Or better:
- Transaction consideration threshold
  → § 35 para. 1a German Competition Act of 2017: EUR 400 Mio.
- Case study: Facebook's acquisition of Whatsapp
  - 2014: WhatsApp had 600 Mio users, transaction consideration: USD 20 Bio
  - Notification to EU Commission; acquisition was cleared on Oct. 3, 2014
  - 2017: Fine of EUR 110 Mio for wrong information regarding technical possibility of automatically matching Facebook and WhatsApp users' identities
  - Bundeskartellamt v Facebook (2019)

Takeover Bids

- = Tender offers in the US
- Direct offer to individual shareholders to buy their shares
- Without regulations of takeover bids → risks of unequal treatment of shareholders and abusive management defences
- Powers of shareholders *versus* powers of directors

Defenses against Hostile Takeovers

- **"Staggered" (classified) board:** board consists of several classes of directors with staggered multi-year terms
- Sale of **"crown jewels"** to make target less attractive
- Seek **"white knight"** (friendly acquirer)
- **"Poison pills":** Entitle target's existing shareholders to large amounts of target's securities or cash in certain events, e.g. unapproved bid
- **"Pac Man" defense:** start bid for bidder itself
- **"Golden parachutes":** entitle target's management or employees to large severance payments if there is a change in control

EU Regulation of Takeovers – History

- Conflicting Member State attitudes to takeover bids (First Commission draft in 1989; Directive in 2004)
- Hence: Instead of detailed harmonization of rules
  → (only) framework directive with EU-wide minimum standards
- **Takeover Directive** (Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids)

EU Regulation of Takeovers – Definition

- Article 2.1(a): **"Takeover bid"** is
  - a public offer
  - made to the holders of the securities of a company to acquire all or some of those securities
  - whether mandatory or voluntary
  - which follows or has as its objective the acquisition of control of the offeree company.

EU Regulation of Takeovers – General Principles (Article 3)

- "*Equivalent" treatment* of shareholders
- Holders of securities of offeree company must have *sufficient time* and information to enable them to reach properly informed decision
- Offeree board "must act in the *interests* of the company as a whole"
- False markets must not be created in securities of offeree company, offeror company or other company concerned by the bid
- Offeror to announce bid only after ensuring it can fulfill consideration commitment
- Target company must not be hindered in conduct of its affairs for longer than is reasonable by a bid

EU Regulation of Takeovers – Applicable Law (Article 4)

- For supervision of bid, bid procedure, price, disclosure, etc. (→ *security regulation matters*):
  Member State where target company has registered office
  Exception: If no voting securities listed on a regulated market there, Member State's law where securities were (first) listed.
- For *company law matters*, including defense tactics and breakthroughs, and information to be provided to offeree employees: Member State's law where target company has its registered office.
- If payment includes offeror's securities (not only by cash), *prospectus* generally must be approved by competent authority of Member State where offeror has registered office (Prospectus Directive, Art. 13[1])

EU Regulation of Takeovers – Disclosure Requirements (Art. 6, 9, 10)

- Offeror: minimal requirements for offer document
- Target/offeree company:
  - With respect to particular bid: BoD must draw up and make public document setting out its reasoned opinion of offeror's bid and strategic plans for offeree company, and of effects on company's interests, specifically including employment. If employees' representatives give separate opinion, board must append it to document.
  - Regular disclosure (in annual report and/or annual shareholders meeting) by all companies with securities admitted to trading on Member State regulated market.

EU Regulation of Takeovers – Substantive Requirements

- Mandatory bid by offeror who has acquired control, for all holdings of minority shareholders, at equitable price (Art. 5 Directive).
  - Exemption if original bid to all the shareholders for all the shares
  - National derogations
- Time for acceptance of bid: 2-10 weeks (subject to extension), as provided by Member State (Art. 7).
- Squeeze-out right: After offeror holds 90-95% of offeree voting capital and voting rights, must be allowed – within 3 months – to require all remaining shareholders to sell him their securities at fair price (Art. 15).
- Sell-out right: In same circumstances where offeror has squeeze-out right under Art. 15, remaining shareholders have right to require offeror to buy their securities at a fair price (Art.16).

EU Regulation of Takeovers – Board Neutrality Rule (Art. 9)

- Restrictions on post-bid defensive measures
  - During the bid period, target company's board must obtain shareholder approval before taking any action "which may result in the frustration of the bid" (other than seeking alternative bids), including implementation of pre-bid decisions out of the ordinary course of business (e.g. certain share buy-backs, sale of "crown jewels" or issuance of "poison pills").

EU Regulation of Takeovers – "Breakthrough" Rule (Art. 11)

- Neutralizes pre-bid defenses during takeover
  - Share transfer restrictions in offeree's articles or contractual agreements do not apply vis-à-vis offeror during bid acceptance period or after offeror has acquired at least 75% of voting stock.
  - Voting restrictions or multiple voting rights do not apply at shareholders' meeting to authorize post-bid defenses or following offeror's acquiring at least 75% of voting stock.
  - Extraordinary shareholder rights to appoint or remove board members pursuant to offeree's articles of association will not apply after offeror has acquired 75% of voting stock.
  - However: "Equitable compensation" to be provided for any loss suffered by holders of rights removed by breakthrough.

EU Regulation of Takeovers – Opt-out of Restrictions on Defenses (Art. 12)

- Option given to Member States not to make board neutrality and breakthrough rules mandatory for their domestic companies (para. 1)
- Reversible option given to companies to opt in (para. 2)
- Even if the company's shareholders choose to opt in, the Member State may exempt the company if it becomes the subject of a bid from a company not applying the Articles, if this *reciprocity "opt-out"* is authorized by a shareholders' meeting not earlier than 18 months before bid is announced (para. 3 and 5)

CH Regulation of Takeovers

- Art. 125 ff Financial Markets Infrastructure Act (FMIA)
- Ordinance of the Takeover Board on Public Takeover Offers
- Scope: Public offers for investments in target companies listed in Switzerland
- Takeover Board as the competent authority

CH Regulation of Takeovers – Principles

- Fairness and transparency
- Equal treatment of shareholders
- Reporting obligations to the Takeover Board
- Publication of the public offer in a prospectus
- Examination of the offer by the Takeover Board
- Requirements regarding the offer period
- Best price rule
- Board neutrality rule

CH Regulation of Takeovers – Offer Period

- Pre-announcement of the offer
- Offer prospectus
- Cooling period (usually 10 trading days)
- Offer period:
  - Normally 20, exceptionally 10 trading days
  - No more than 40 days
- Announcement of the interim result
- Right of subsequent acceptance if interim result is successful (10 trading days)
- Announcement of the final result

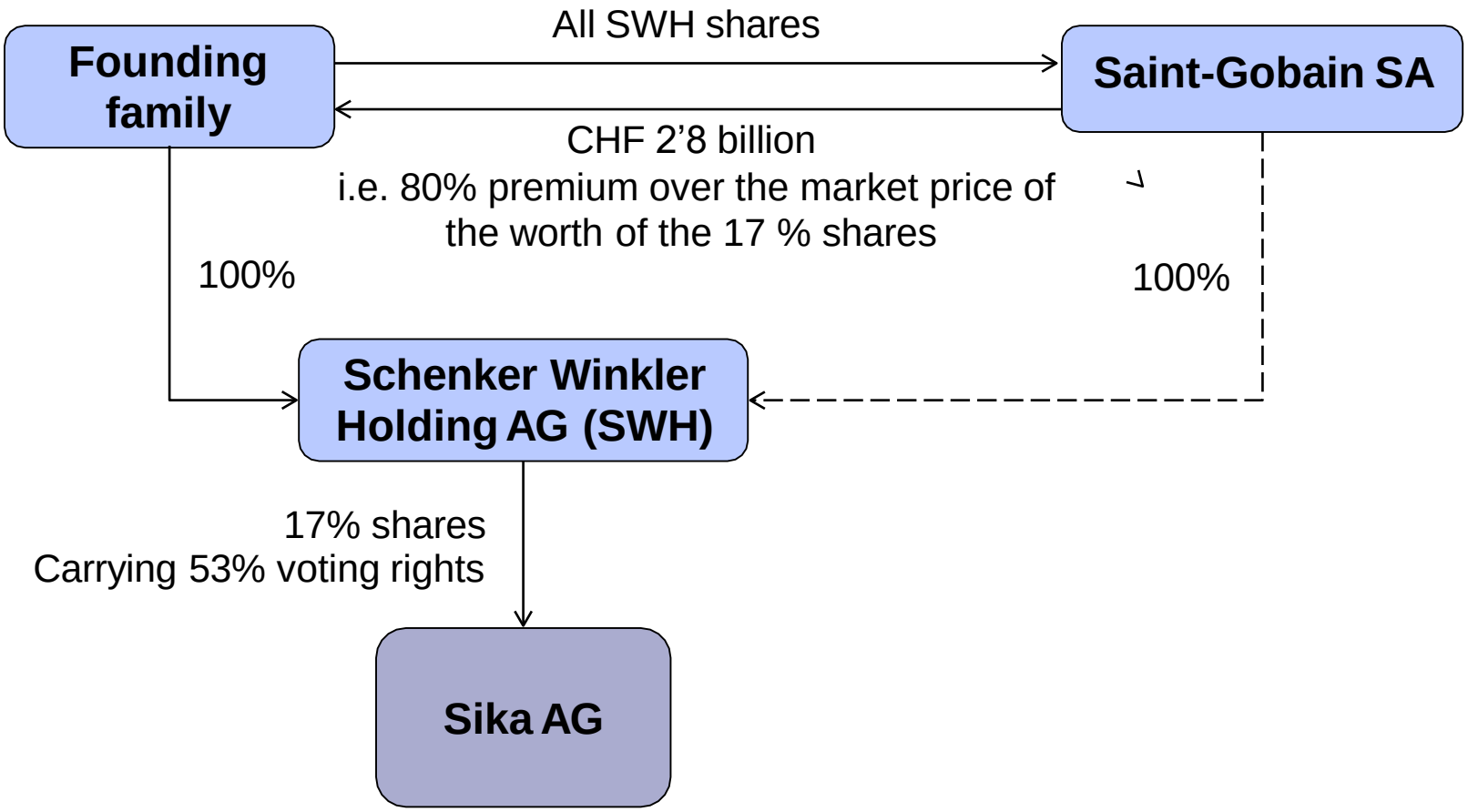
CH Regulation of Takeovers –

- Mandatory bid (Art. 135 FMIA) – “Control”:
  - If acquirer obtains more than 33 1/3% of the voting rights of target – “directly, indirectly or concerted”
  - Target may raise this threshold in its articles of association up to 49% of the voting rights
  - Price offered as high as the higher of:
    - Market price
    - Highest price paid by offeror in the previous 12 months
  - Opting-out clause in the Articles of Association
  - Exemptions from the duty to make a mandatory offer (see next slide)
- Cancellation of outstanding shares (Art. 137 FMIA)
  - If offeror, upon expiry of the offer period, holds more than 98% of the voting rights, has 3 months to petition the court to *squeeze out* minority shareholders
- *Cash-out merger* (Art. 8 para 2 and 18 para 5 Merger Act) = squeeze-out if acquirer obtains 90% of the voting rights of the target company)

CH Regulation of Takeovers – Defenses

- Reporting requirement to the Takeover Board
- Restrictions on defensive measures (Art. 36-37 of the Ordinance of the Takeover Board on Public Takeover Offers, TOO)
- Restrictions on defensive measures
  - Shareholder approval required:
    - To sell or acquire assets the value or price of which exceeds 10% of the balance sheet total (**"scorched earth defense"**)
    - To sell assets that form part of the main subject matter of the offer (**"crown jewels defense"**)
    - To enter into contracts with members of the board that provide for unusually high remuneration payments if they leave the company (**"golden parachutes"**)
    - To issue shares on the basis of the authorized capital without granting subscription rights to shareholders (**"poison pills"**)
  - Prohibition of defensive measures that clearly infringe against the provisions of corporate law

Sika – Hostile Takeover Battle (CH)



Sika – Articles of association

- [4] Voting rights restriction for acquirer of shares with privileged voting rights → BoD *can* cap at 5 %.

  Acting as a group to circumvent [4] also allows for voting rights restriction.

- [5] Opt-out from mandatory bid rule

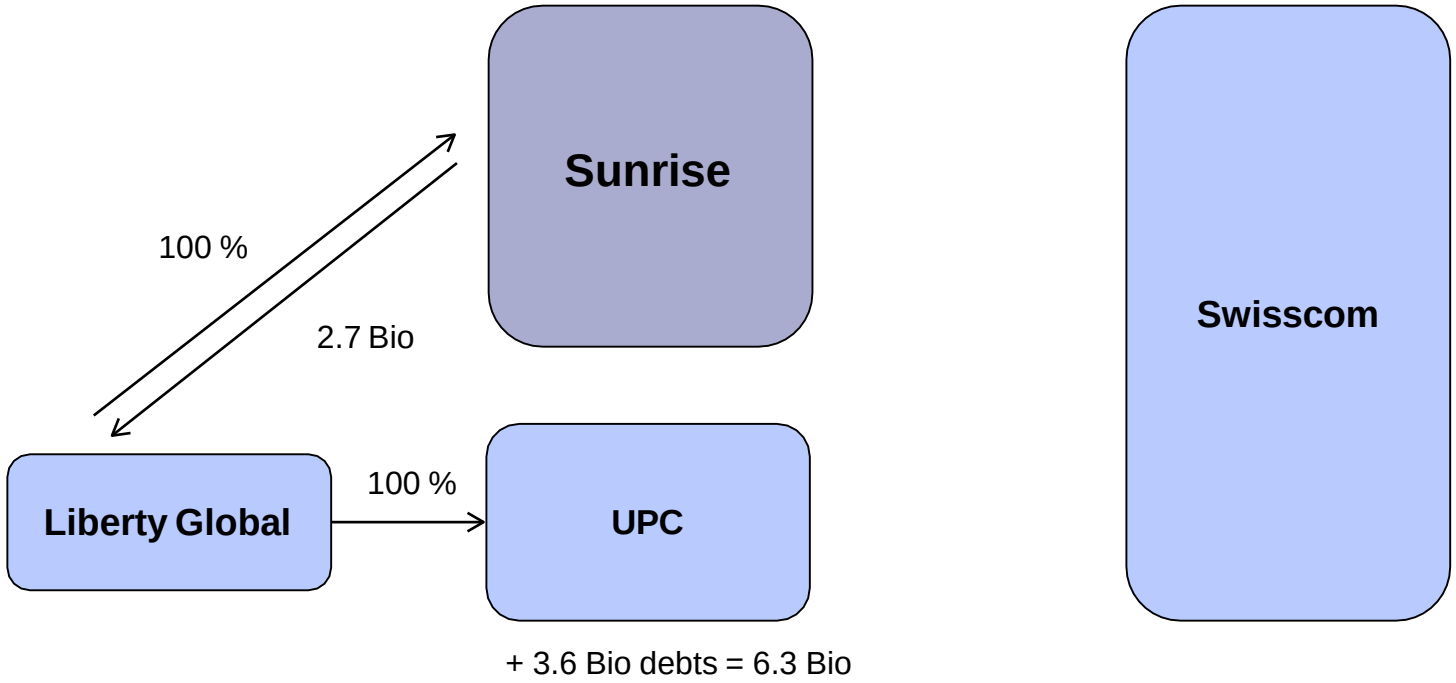
Sika – Hostile Takeover Battle (CH)

- Dec 2014 – Contractually intended course of action:
  - Step 1: SWH votes out non-compliant BoD members
  - Step 2: Saint-Gobain gains control over SICA indirectly by acquiring SWH
- Counteraction:
  Sika BoD (opposing the control transaction) restricts SWH's voting rights to 5 %
- SWH filed a *civil suit* against Sika – Arguments and Outcome:
  - Indirect acquisition is not covered by [4]
  - SWH and Saint-Gobain did not act as a group in the sense of [4]
  - Court of First Instance Zug dismissed the action
- Bill and Melinda Gates Foundation sued on the *administrative track*
  - Foundation held 3 % of Sika; wanted to receive the 80 % premium over market price – mandatory bid duty?
  - Argument: [5] does not apply in the case of an indirect acquisition
  - Federal Administrative Court held that opt-out applies – no mandatory bid duty

Sika – Outcome

- Settlement outside of court
- Sale of all shares by Burkhard family to Saint-Gobain
- Saint-Gobain subsequently sells 7 % to Sika, which “destroys” these shares through a capital reduction
- Result: Saint-Gobain holds 10 % of all shares
  (2nd largest shareholder is Blackrock with 9.3 % of all shares)
- One share, one vote → end to excessive voting powers
- Any draft decision of Appeals Court of Zug (‘Obergericht’) will remain sealed; decision of first instance (‘Kantonsgericht Zug’) establishes precedent on shareholder voting rights restrictions (‘Vinkulierung’)
- May 2020: Saint-Gobain sold all (10 %) share right after elapse of two-years stock lockup

Sunrise‘s attempt to acquire UPC (1)

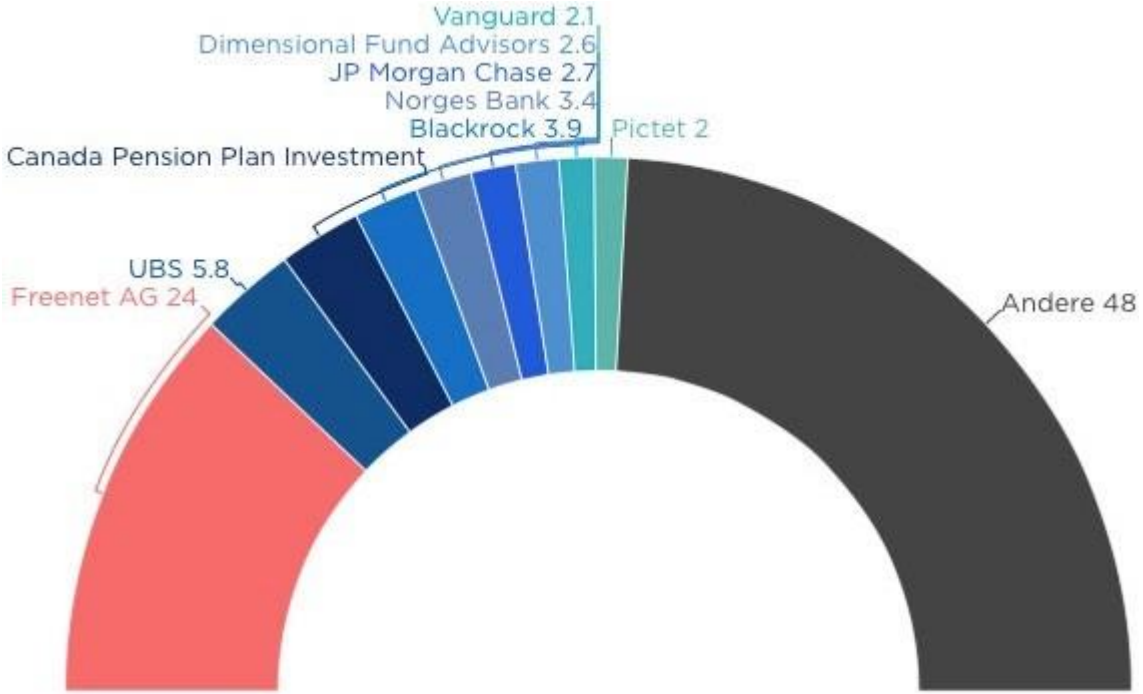


Sunrise‘s attempt to acquire UPC (2)

- How to pay for the 6.3 Bio acquisition?
  - Equity capital increase (First planned CHF 4.1 Bio, now 2.8 Bio)
  - Dept capital increase (First planned CHF 2.2 Bio, now 3.5 Bio)

- ComCo cleares acquisition after exhaustive examination:
  No risk of elimination of competition;
  further: „mobile technologies can increasingly be utilized as a cost-effective substitute for broadband cable internet“.

Sunrise‘s attempt to acquire UPC (3) – Sunrise shareholders



Quelle: Bloomberg | Stand: August 2019

Sunrise‘s attempt to acquire UPC (4)

- Freenet opposed the acquisition; arguments:
  - Why cable when there is 5G?! „Cellular substitutes cable“
    → We do not want the acquisition (too expensive/unnecessary)
  - In case of acquisition: Our share proportion gets diluted
    (since we don‘t want to/cannot participate/subscribe for new stocks)
  - Effect: „Atomised“ shareholders
    → From minority to management control –
    management would have even more freedoms
- Oct 10, 2019: Advisory group ISS recommends shareholders to vote against

> “On balance, Sunrise appears to be overpaying for assets in a transaction that appears to have debatable long-term strategic merit. As such, shareholders are recommended to vote against the transaction at this time,” ISS said in a document seen by Reuters.

Sunrise‘s *failed* attempt to acquire UPC (5)

- Oct 20, 2019: Media reports suggest Sunrise considering complaint to FINMA
  - Freenet supposedly encouraged „friendly investors“ to become Sunrise shareholders below 3 % threshold (no reporting obligation, cf. Art. 120 FMIA)
  - But: „Shareholder group“ that has 24+ %? → failure to report
  - Or even: Art. 135 FMIA → mandatory bid?
- Oct 23, 2019: extraordinary shareholder meeting
  - Cancelled on Oct 22, 2019
  - Expected cost of failed attempt: up to CHF 125 Mio (Break-up fee 50 Mio, lawyers, spindoctors, advertisements etc.)
  - Sunrise‘s CEO steps down; BoD chairman doesn‘t stand for re-election
- What happened next? Liberty Global acquires Sunrise (!)

Liberty Global's Sunrise acquisition

- Pro memoria: Liberty Global is the 100 % parent company of UPC
- August 12, 2020: Cash offer (CHF 110 per Sunrise share; 32 % premium)
- What about Freenet? – Agreed beforehand to tender its shares
- ComCo (still) cleares the acquisition (now only preliminary examination)
- November 12, 2020: Liberty Global acquired 98 % of Sunrise shares; squeeze-out procedure, Sunrise shares got delisted
- „Nothing will change for UPC and Sunrise customers"; (marketing jargon:)

The ultimate goal is to merge UPC and Sunrise into one great new Swiss company in early 2021, and we will now continue working together on the integration. With this new company, we will have a unique combination of Switzerland's leading gigabit fiber optic cable network and one of the best mobile networks in the world. This fixed-mobile convergence will create a real, even stronger challenger that will drive competition and innovation in the Swiss market.

US Regulation of Tender Offers – Definition

- "Tender offer" defined in case law. Characteristics include:
  - active and widespread solicitation of public shareholders;
  - solicitation made of substantial percentage of the issuer's stock;
  - offer to purchase made at premium over prevailing market price;
  - terms of the offer are firm rather than negotiable;
  - offer contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased;
  - offer open only for a limited period of time;
  - offeree subjected to pressure to sell his or her stock; and
  - public announcement of purchasing program precedes or accompanies rapid accumulation of the target's securities."

US Regulation of Tender Offers – Federal Law

- Goal of U.S. securities law: protection of U.S. public investors
- Certain extraterritorial application due to the residency of the investors or the means by which the offer is made
- **Securities Exchange Act of 1934:** Principally Section14(d)-(e), and related SEC rules (17 CFR II Part 240).
- Scope: Applies to tender offers made for securities registered under Section 12 of Securities Act of 1934
- Disclosure requirements and substantive regulation → see next slides
- But: *No mandatory bid rule on Federal level*

US Regulation of Tender Offers – Disclosure requirements under 1934 Act

- Offerer's duties: Filing of tender offer statement with SEC and copies sent to issuer, security holders, any competing bidders and each exchange where target's stock is listed
  → dissemination of information
- Offeree's duties: BoD statement published and filed with SEC within 10 business days = whether it recommends acceptance or rejection, is neutral or cannot take position, and reasons therefore (Rule 14e-2)
- 2000 SEC Amendments: Permission of increased communications before filing disclosure document, i.e. without triggering commencement of the offer

US Regulation of Tender Offers – Substantive Regulation

- Offeree/Target Company: Can't purchase own equity securities during tender offer unless first files statement with SEC as to amount and purpose
- Offeror/Acquiring Company: Can't purchase securities which are subject of tender offer outside the offer, from time tender offer is publicly announced until it is terminated (Rule 14e-5)
- Terms of tender offer:
  - Shareholders' right to withdraw securities tendered during offer period (1934 Act S. 14(d)(5); Rule 14d-7)
  - Pro-rata acceptance of shares if more shares are tendered than covered by bid (! Impossible under mandatory bid regimes)
  - Offer period: must be at least 20 business days plus 10 business days after any change in offering price or amount (Rule 14e-1)
  - "Best-price" rule (Rule 14d-10)

US Regulation of Tender Offers – State Law

- Current state statutes differ.
  - US states generally in favor of tender offers because of the prevailing view that they lead to efficiency in the market
  - However, adoption of anti-takeover statutes in certain states i.e. provisions protecting against hostile bids
- Company laws
  - Law of incorporation governs the duties of BoD (fiduciary duties, business judgment rule apply), rights of stockholders, etc., including in tender offer situation.
  - E.g. rather than *per se* illegality of certain defenses, Delaware expects board to use only defensive measures that are reasonable in relation to threat. Risks: uncertainty and court challenge.

Mergers

- Corporate reorganization leading to disappearance or dissolution (other than through liquidation) of company and transfer of assets and liabilities to another company
- Purpose
  - Exploiting economic synergies → economies of scope
  - Achieving a critical size → economies of scale
  - Corporate inversions: Reducing income taxes
    - Medtronic Inc. (US) – Covidien PLC (Ireland) = Medtronic PLC ($49.9 billion deal completed in January 2015)
    - AbbVie Inc. (US) – Shire PLC (Ireland) ($54 billion deal deterred in October 2014; $1.6 billion break-up fee)

Mergers (EU)

- **Council Merger Regulation** (Council Regulation (EC) no. 139/2004 on the control of concentrations between undertakings)
  - Pre-implementation notification to European Commission of proposed “concentration” with a “Community dimension”
  - Exclusive authority to Commission to assess concentration’s compatibility with common market based on impact on competition
- **Company Law Directive** 2017/1132/EU
  - Shareholders’ rights to vote on the merger (qualified majority of at least two thirds of the votes attached either to the shares or to the subscribed capital represented; Art. 93 I)
  - Shareholders’ rights to inspect merger documents at least 1 month before the date fixed for the general meeting (Art. 94 I lit. b) – reason: proper information

Mergers (EU) – 10th Directive on Cross-Border Mergers (2005) → Directive 2017/1132

- Scope: limited-liability companies at least two of which are governed by laws of different Member States
- Simple framework based on national rules for domestic mergers and avoiding winding-up of acquired company. In general, *cross-border mergers must be permitted if the national law of the relevant Member States permits domestic mergers between such types of companies*.
- Governed by the law that would apply if it were a domestic merger
- Inspection period: Common draft terms of the cross-border merger shall be published at least 1 month before the date of the general meeting (Art. 6 Directive 2005)
- Repealed by Directive 2017/1132 relating to certain aspects of company law (see slide before)

Mergers (CH)

- Merger Act (entry into force: July 2004; c.f. Regulation 139/2004)
- Merger types
  - Merger by absorption / by combination
  - Cash-out merger (consent of 90% of the members of the acquired company who hold voting rights)
- 30-days inspection period: Right of shareholders to consult merger documents before the general meeting
- Approval of the merger agreement by the general meeting (two thirds of the votes represented at the meeting and an absolute majority of the nominal value of the shares represented)
- Pre-implementation notification to the Competition Commission
  - Concentration: Merger or acquisition of control, see Art. 4 para. 3 Cartel Act
  - Decision of the Competition Commission authorizing or prohibiting the merger; preliminary/exhaustive examination; deadlines: 1/4 month(s); clearance fiction

Mergers (US)

- **Clayton Act; Hart-Scott-Rodino Antitrust Improvements Act:** Mandates pre-implementation notification to Federal Trade Commission and Antitrust Division and waiting period (to permit competition assessment) before acquisition of threshold values of another person's assets or securities. Exception for financial institutions, but these must notify bank regulators
- **Federal securities laws:** SEC regulates both (1)the deemed "offer" of the acquirer's securities which the target company's shareholders will receive in connection with the merger; and (2)the proxy statements furnished to shareholders in connection with the shareholders' meetings authorizing the merger.
- **State laws** also regulate merger approval requirements, especially in terms of company law

Section 7 Clayton Act

"No person … shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where … the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

(15 USC § 18)

Elements:

1. mergers, acquisitions & joint ventures
2. "substantial lessening of competition"

Horizontal merger project review

- Identification of relevant markets (products and geography, cf. above), market participants, competitive concerns, remaining substitutes
- DOJ and FTC, Reviewed Horizontal Merger Guidelines (2010)
- Market shares and concentration levels pre- and post merger: **Herfindhal-Hirschman Index (HHI)**

$$HHI = s_1^2 + s_2^2 + s_3^2 + \ldots s_n^2$$

where:

s_n = the market share percentage of firm n
expressed as a whole number, not a decimal

Implications of HHI increases

- Post-merger increase in HHI less than 100 points
  → *Unlikely to have adverse competitive effects and ordinarily requires no further analysis*
- Post-merger HHI below 1‘500 points
  → *Unconcentrated market; unlikely to have adverse competitive effects and ordinarily requires no further analysis*
- Post-merger HHI between 1‘500 and 2‘500 and increase in HHI over 100 points
  → *Moderately concentrated market; potentially raises significant competitive concerns and often warrants scrutiny*
- Post-merger HHI over 2‘500 and increase in HHI between 100 and 200 points
  → *Highly concentrated market; potentially raises significant competitive concerns and often warrants scrutiny*
- Post-merger HHI over 2‘500 and increase in HHI over 200 points
  → *Rebuttable presumption that the merger likely will enhance market power*

Further criteria

- Potential for unilateral prices raises or output reduction post-merger
- Potential for coordinated action or collusion post-merger
- Timely, likely and sufficient market entry of new competitors post merger?
  → contestability of involved markets
- Failing firm defense: exit absent merger

Non-horizontal merger project review

- Mergers involving potential competitors
  - Elimination of future competition?
  - One party widely perceived as potential competitor → constraining factor?
- Mergers involving firms that operate at different levels of an industry
  - Increasing barriers to entry since entry in both markets becomes necessary?
  - Facilitation of collusion?
  - Special situations in (partly) regulated markets

Thank you!

Best wishes and good luck with the exam!