

Research on the Legal Review Standard of Anti-hostile Takeover by Listed Companies

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Abstract: With the acquisition and merger of various companies in the international economic market becoming more and more common, the phenomenon of hostile takeover in order to obtain the interests and competitiveness of the company is also more and more, the target company to prevent hostile takeover also created a lot of anti-hostile takeover measures. The legal regulations of anti-hostile takeover are different in different countries, but the types of anti-hostile takeover events are rich, so that the current legal regulations are not perfect, the legality premise of anti-hostile takeover cannot be effectively guaranteed, and the legality of anti-hostile takeover cannot be effectively reviewed. Therefore, this paper will use research method, case analysis method and summary method to solve the problem that the current legal review standard is relatively vague and insufficient. It holds that a more reasonable legal review standard of anti-hostile takeover should be established by establishing relevant legal principles, reasonably distributing the decision-making rights of shareholders and the board of directors, confirming the rights and obligations of the decision makers of anti-hostile takeover, and protecting the interests of minority shareholders and employees.

Keywords: anti-hostile takeover; principles of law; review of legality

1. Introduction

At present, in order to ensure the interests of the company and shareholders, various companies in the international economic market have applied a variety of anti-hostile takeover measures against hostile takeover, but the emergence of anti-hostile takeover measures will also lead to problems such as damage to the interests of shareholders for personal interests, abuse of rights and so on. Therefore, the review of the legality of anti-hostile takeover has become a concern of the judicial and business community. Anti-hostile takeover refers to the countermeasures against the acquisition activities carried out by the acquiring company without the permission of the board of directors of the target company, regardless of the consent of the other party.

In the face of the cash offer of Olinke and Revlon and the hostile takeover by Conlinton, Gillette adopted a large number of low-priced new shares to reduce the proportion of the acquirer's equity to achieve the purpose of anti-hostile takeover. This is a classic anti-hostile takeover case in the United States, but whether various anti-hostile takeover measures are legal, whether they conflict with current regional laws, and whether they will damage the interests of the company, shareholders and related persons have become the issues to be concerned in the legality review of anti-hostile takeover.

The UK believes that the board of directors should not violate the principle of loyalty to implement the anti-hostile takeover; The United States does not oppose the implementation of anti-hostile takeover and believes that whether the anti-hostile takeover behavior of the board of directors is recognized needs to be reviewed by standards such as Revlon standards and Unocal standards. However, the legal regulation of anti-hostile takeover in China is still vague. But are the legal regulations and legal review standards of various countries really reasonable? Is there a reasonable standard review content for the legality review of corporate anti-hostile takeover in different national political backgrounds? Therefore, it is very meaningful to study the legal review standard of anti-hostile takeover of listed companies.

2. Current British and American Legal Regulations and Review Standards

2.1. Current Legal Norms and Review Standards in the UK

Hostile takeovers in Britain began in the early 1950s, with the increase in popularity of the take-over as a means of acquiring control of public companies the city [1]. In the early stage, there are usually three methods to solve the disputes related to hostile takeover. One is the shareholder's lawsuit, but this method will be limited by regular norms and fund litigation. The second is to resort to the committee for investigation, and its review is generally based on the Company Law and the trust principle; The third is that shareholders can exercise voting rights to discipline managers [2]. However, with the increasing number of hostile takeover incidents, the board of directors began to take various defensive measures, and the courts tried to use the Company Law and other general legal norms to solve these disputes. In fact, the common law has always allowed the managers of companies to take decisions, but the court adopted a costly and unpredictable method, which is unacceptable to many investors. Thus, in the autumn of 1959, the Banking Commission announced the adoption of the Bill on the Consolidation of British Businesses (the "Bill"), drafted by the Governor of England and the City Working Group. It contained a series of general guidelines "primarily concerned with safeguarding the interests of shareholders". The relevant principles of shareholder primacy and board neutrality were thus established. However, due to the lack of enforcement mechanisms, various problems emerged in the takeovers of the 1960s, so the Governor of the United Kingdom again organized the revision and drafting of a new regulation, which is the City Code of the United Kingdom. The City Code prohibits the Board of Directors from performing any action that may result in the failure of any request or acquisition without the approval of the General meeting of shareholders. In terms of management functions, the Board of Directors shall not (1) issue or transfer or sell any authorized but unissued shares, or agree to transfer or sell any shares; (2) the issue or grant of options in respect of any unissued shares; (3) to create or issue or permit to create or issue conversion rights, subscription rights to hold shares in any securities; (4) The amount of asset materials sold, disposed of or acquired, or agreed to be sold, disposed of or acquired; (5) Normal business processes other than the conclusion of contracts. Therefore, the relevant laws and regulations in the UK require that the board of directors should remain neutral, and the decision-making behaviour of the board of directors should follow the principle of loyalty, and the board of directors should not implement relevant anti-hostile takeover measures for defence without the approval of the general meeting of shareholders, no matter whether the implementation purpose is good faith or malicious.

2.2. Current Legal Norms and Review Standards in the United States

Unlike the approaches taken by other nations, and by many U.S. states, federal-securities law in the United States is primarily a disclosure-based regime [3]. In the 1960s, American companies usually used competing corporate proxies to replace the board of directors of target companies to achieve a change in corporate control. The main regulatory agencies were the SEC and the federal courts

applying federal laws. In particular Section 14(a) of the Securities Exchange Act of 1934 and implementing the SEC Agency Rules. However, in the medium term, hostile takeovers gradually replace proxy contests and are more efficient and less costly because they can directly skip the board and the shareholders of the target firm to make a tender offer. However, it is followed by the abuse and malicious use of tender offer. Many hostile takeovers will damage the interests of the shareholders of the target company and the overall development interests of the target company. In the face of this situation, due to the short reaction time, the shareholders of the target company will often bid their shares to the hostile bidders to ensure the liquidity of their shares. And the board of directors didn't have time to respond defensively. Therefore, in 1968, the US Congress passed the Williams Act, which, unlike the UK City Code, did not require "mandatory bids," but also did not prohibit and review the board's anti-hostile takeover measures too much. Instead, it left the regulatory review to state courts, Because Delaware is the domicile of most large American public corporations, the conduct of directors of these corporations is governed by Delaware law.

Delaware's regulatory principles apply the regulatory framework of the trust principle, on which more comprehensive and rich review standards have been developed. It formulated three review standards between 1985 and 1988. One is the Unocal standard. Since the decision of the board of directors may have the hidden danger of realizing personal interests, this standard requires the board of directors to prove that the hostile takeover really threatens the interests of the company and shareholders, and the anti-hostile takeover measures adopted by the board of directors are reasonable and good faith. The second is the Revlon standard. In some hostile takeover cases, the independence of the target company can no longer be guaranteed, so the board of directors can only decide to sell the company or conduct a change of control transaction. The price of its sale and the bidder as well as the object of the change of control transaction have the best interests and rationality. The third is the Blasius criterion, which is specifically applied to the "poison pill" of anti-hostile takeover measures. That is, to dilute the shares held by the hostile takeover company by issuing low-priced shares, so as to regain the control and ownership of the target company.

As for the anti-hostile takeover measures in the United States, it does not require the board of directors to remain neutral and prohibit it from making decisions or taking defensive measures without the approval of the general meeting of shareholders like the British legal norms. Instead, it sets relevant legal norms and review standards in procedures, which are analyzed and reviewed according to the specific circumstances of different cases. So as to determine whether the anti-hostile takeover measures of the board of directors are legal and feasible. The choice of this review mode in the United States is an inevitable requirement for the transformation of modern corporate governance structure from "shareholders' meeting centrism" to "board centrism" [4].

3. Standards for Reviewing the Legality of Anti-hostile Takeover

The occurrence of hostile takeover will have a certain impact on the interests of the company and shareholders. For the company, hostile takeover may have an impact on the long-term interest development of the company. Since the acquirer will not comprehensively evaluate the full potential of the acquired company for investment, Therefore, it will not consider long-term shareholding investments [5], which has a certain impact on the long-term development of the company. At the same time, the occurrence of hostile takeover will also make the company's management unable to devote all its energy to the management of the company. According to the Harvard Business Review, 70-90% of deals fail, and 50% of deals fail, 60% actually destroys shareholder value [6]. Therefore, the establishment of anti-hostile takeover legality review standards can also enable the board of directors of the acquired company to prevent these hostile takeovers that damage the interests of the company and shareholders through legally protected defense measures within the legal scope.

3.1. Proportionality Principle

The principle of proportion comes from administrative law, which requires that the exercise of power behavior can achieve the purpose, that the behavior is the optimal choice, and that the positive impact and negative damage brought by the behavior should form a proportion. We believe that the principle of proportion can also be applied to the legality review of anti-hostile takeover. The principle of proportion applies to the dual legal relationship structure of "power-right" and "right-right", and its expression is "modesty". That is, it has become "contractibility", "complementary", "limited", "leniency", "internal accumulation", "last resort" and other elements [7]. To sum up, these characteristics require that in the face of the legality review of anti-hostile takeover, anti-hostile takeover should be the only and best means to safeguard the overall interests and long-term development of the company, and the principle of proportion should be applied in combination with the specific situation, not applicable to all aspects, and can only be used when the relevant laws are defective in the legal regulation of the case. And it must be implemented under the norms of procedural justice. For example, when the United States Unocal standard has limitations in the review of whether the anti-hostile takeover behavior is justified, when the implementation of the anti-hostile takeover provides evidence to prove that the anti-hostile takeover measures are indeed necessary and can prevent the damage to the company's interests caused by the hostile takeover, and the company's shareholders prove that the anti-hostile takeover will bring the damage to the interests of shareholders, The current legal regulation and examination standards have defects and are difficult to judge. In this case, the proportionality principle can be used to review and evaluate the relevant materials in the court and in the process of evidence, which can solve this problem well.

3.2. Rationally Allocate the Rights of Anti-hostile Takeover Decisions

In the current legal norms, the City Code of the UK and the principle of loyalty restrict the defensive measures of the board of directors, requiring that all the behaviors of the board of directors should not violate the principle of loyalty. The Williams Act of the United States and the relevant review standards of the Delaware Supreme Court base the decision-making power on the board of directors under the condition that the behavior is legitimate and legal. However, whether the decision-making power is given to the general meeting of shareholders or the board of directors, one party will have too much power and pose a threat to the interests of others. Therefore, we believe that we can learn from the Japanese committee structure and the measures of independent directors, set up supervision departments within the company, government departments and third-party neutral departments, and combine relevant standards. To ensure the neutrality and fairness of the review work through the review by a neutral organization that has no interest or emotional relationship with the Company and all parts of the Company, to reasonably allocate the decision-making power of anti-hostile takeover based on the results of evaluating the development of the Company and the overall interests of the Company, and to ensure the legitimacy of the purpose of anti-hostile takeover and the necessity of implementation; Prevent the use of rights to achieve personal ends and damage the overall interests of the company.

3.3. Establish the Rights and Obligations of Anti-hostile Takeover Decision Makers

In fact, the essence of both laws and regulations and normative standards is the establishment of rights and obligations, so the correct establishment of rights and obligations can effectively regulate the legal implementation of anti-hostile takeover. We believe that the implementation of anti-hostile takeover by the board of directors needs to fulfill three aspects of obligations.

The first is the authenticity of information disclosure. For example, the Williams Act of the United States and the Securities Act of the PRC require access to information, management information and

business information to ensure openness and transparency of the process. Similarly, in the implementation of anti-hostile takeover measures, in order to ensure the legality and fairness of the procedures and the rationality of the purpose, the board of directors should be required to truly and comprehensively disclose the relevant information of anti-hostile takeover measures, the company's operating conditions, relevant purposes and obligations, so that the personnel of the review institution can have a more comprehensive understanding of the motivation and impact of anti-hostile takeover measures. So as to effectively review the legality of this behavior and prevent the behavior of hiding, forging and tampering with relevant information in order to achieve personal interests at the expense of the company's collective interests and shareholders' interests.

The second is to maximize the interests of shareholders. British law, American law and Chinese company law have different expressions on the rights and obligations of the board of directors and shareholders, but in essence they all recognize the board of directors as an executive body to a certain extent and require the board of directors to be responsible for the interests of shareholders. Therefore, the board of directors shall not violate the unified requirements of safeguarding the interests of shareholders under any circumstances, and its decisions must be made around the interests of shareholders. The interests of shareholders shall not be harmed, so the purpose of anti-hostile takeover cannot be separated from this requirement.

The third point is the inversion of burden of proof, which comes from the Unocal standard of Delaware Supreme Court. It requires the board of directors to prove the rationality of the threat of hostile takeover and the safeguard measures before legally implementing the anti-hostile takeover, and the inversion of burden of proof can better regulate the legitimacy and rationality of the implementation of anti-hostile takeover. The relevant materials and evidence provided by the party carrying out the act can also help the review agency to conduct the legality review more efficiently. Therefore, the anti-hostile takeover board should be obliged to actively prove that hostile takeover does pose a threat to the interests of the company and shareholders, and the anti-hostile takeover behavior has the necessity and legitimate reasons for implementation.

At the same time, in order to solve the problem that many people are unwilling to serve on the board of directors due to the risk of responsibility and some unpredictable circumstances, such as the malicious provision of false information by relevant departments or the judgment error caused by subjective factors, and to ensure that the legitimate rights and interests of the board of directors are protected when performing their obligations, corresponding relief measures should be formulated. To protect the legitimate rights and interests of the Board of Directors by utilizing the government or a third-party specialized review agency to conduct review. For example, public materials should be reviewed and traced to ensure their integrity and authenticity. At the same time, the board of directors should bear limited liability to prevent the board of directors from taking full responsibility for being misled by others or making wrong decisions, that is, losing the balance of rights and obligations. In addition, boards have access to a grievance process through which they can demonstrate the legality and necessity of their own actions.

3.4. Protect the Interests of Minority Shareholders and Employees

The City Code in the UK, the Williams Act in the US, and the trust principle all emphasize the maintenance of the interests of shareholders' meetings and companies, but often ignore the legitimate rights and interests of minority shareholders and employees. All shareholders of the target company shall be treated equally according to the nature and number of shares held by them. Joint stock companies implement the capital majority system, and there is substantial inequality between major shareholders and small shareholders. Major shareholders have more voting rights because they hold the majority of shares, and they can even deprive the rights and status of minority shareholders [8]. To solve this problem, we believe that we can establish: (1) the company's anti-hostile takeover

information disclosure system, that is, the relevant information and materials of anti-hostile takeover are truthfully disclosed, so that minority shareholders and employees have the right to know, and can understand the relevant situation in advance and make relevant reactions; (2) Establishment of an independent board of directors, that is, when the board of directors of the company is established, The board member of a management company is regarded as a neutral person who has no beneficial or emotional relationship with the company [9]. This measure can maximize the guarantee that the board of directors can make decisions for the overall interests of the company rather than use power to achieve personal goals, and prevent limited decisions due to emotions, interests and other relations; (3) The right of minority shareholders and employees to vote at the decision-making meeting shall be established. For the right of employees to vote, an employee may be selected as a representative to speak at the shareholders' meeting after collecting the opinions and views of employees. In the voting, the employee representative representing all employees shall count as one vote, and the decision passed by more than two-thirds of minority shareholders shall also count as one vote. In this way, employees and minority shareholders can be given certain rights to safeguard their legitimate rights and interests, rather than being dominated by the management and the general meeting of shareholders.

However, conflicts of interest will inevitably occur while protecting the interests of various parts and personnel of the company. For example, when the interests of minority shareholders, employees and the general meeting of shareholders conflict, the specific distribution of weights to protect the interests of minority shareholders and employees and safeguard the interests of the general meeting of shareholders and the overall interests of the company has become an important requirement for the legality review of anti-hostile takeover. On the issue of conflict of interest, We believe that employee stock ownership measures can be used. ESOP is a popular corporate governance practice in the world, and one of the most effective incentive systems in developed companies in western countries [10]. Employees who have contributed value and good performance to the company are allowed to hold shares at low or zero cost. On the one hand, this measure can weaken the interest conflict between shareholders and employees, realize the integration of shareholders' and employees' interests, and encourage employees to work for the company more conscientiously and faithfully, which is also helpful for the long-term development of the company. In the face of the legitimacy review under the conflict of interest, the employee shareholding measure can be used to transform the proportion of opinion reference in the decision-making meeting into the proportion of equity. When one opinion holds more than half of the company's equity or the largest number of shares held by all the opinions, its opinion reference utilization rate should be the highest, which can better solve the problem of conflict of interest.

4. Conclusion

The setting of laws and regulations regulates behaviors at the legal level through the establishment of rights and obligations, but at the same time, the setting of laws and regulations can also provide legal basis and legal guarantee for the implementation of behaviors. As for the occurrence of more and more frequent hostile takeover events and the implementation of anti-hostile takeover measures, the laws and regulations of various countries have reflected an obvious lag in the regulation of various types of derived hostile takeover and anti-hostile takeover behaviors. Therefore, according to the different national conditions of different countries, it is necessary to set up relevant laws and regulations and review standards for regulation. Anti-hostile takeover measures are countermeasures taken by the acquired company to prevent damage to its own interests. Therefore, the establishment of a set of reasonable legality review standards for anti-hostile takeover can ensure the implementation of anti-hostile takeover under the premise of legality regulation and guarantee. So that the anti-hostile takeover measures can really protect the interests of the company, the board of

directors, shareholders and the relevant members of the company from being harmed, rather than achieving improper purposes.

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