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The International Comparative Legal Guide to:

Mergers & Acquisitions 2016

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A practical cross-border insight into mergers and acquisitions

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Strategic Partners

General Chapters:

1	**Divergence / A Game of Two Halves?** – Michael Hatchard & Scott Hopkins, Skadden, Arps, Slate, Meagher & Flom (UK) LLP	1
2	**Takeover Defences in Europe – The Debate on Board Passivity is Moot** – Scott V. Simpson & Lorenzo Corte, Skadden, Arps, Slate, Meagher & Flom (UK) LLP	4
3	**Bridging the Value Gap in 2016** – Alex Kay & Caroline Rae, Herbert Smith Freehills LLP	6
4	**Current Developments in the Roles and Responsibilities of Financial Advisers in Public M&A Transactions** – Richard Hall & Gary A. Bornstein, Cravath, Swaine & Moore LLP	11
5	**The Nancy Reagan Defence in 2015: Can a Board Still Just Say No?** – Adam O. Emmerich & Trevor S. Norwitz, Wachtell, Lipton, Rosen & Katz	16

Country Question and Answer Chapters:

6	**Albania**	Gjika & Associates: Gjergji Gjika & Evis Jani	20
7	**Argentina**	Severgnini, Robiola, Grinberg & Tombeur: Carlos María Tombeur & Matías Grinberg	27
8	**Armenia**	Concern Dialog Law Firm: Narine Beglaryan & Yuri Melik-Ohanjanyan	33
9	**Australia**	Allens: Vijay Cugati	38
10	**Austria**	Schoenherr: Christian Herbst & Sascha Hödl	45
11	**Belarus**	Sysouev, Bondar, Khrapoutski: Alexander Bondar & Elena Selivanova	55
12	**Belgium**	Astrea: Steven De Schrijver & Jeroen Mues	62
13	**Bermuda**	MJM Limited: Peter Martin & Brian Holdipp	71
14	**Bolivia**	Guevara & Gutiérrez S.C. – Servicios Legales: Jorge Luis Inchauste	78
15	**Bosnia & Herzegovina**	CMS Reich-Rohrwig Hainz: Nedžida Salihović-Whalen	83
16	**Brazil**	Demarest Advogados: Gabriel Ricardo Kuznietz & Thiago Giantomassi Medeiros	92
17	**British Virgin Islands**	Maples and Calder: Richard May & Matthew Gilbert	101
18	**Bulgaria**	Schoenherr: Ilko Stoyanov & Katerina Kaloyanova	107
19	**Cayman Islands**	Maples and Calder: Nick Evans & Suzanne Correy	115
20	**China**	Zhong Lun Law Firm: Lefan Gong	121
21	**Colombia**	Peña Mancero Abogados: Gabriela Mancero	128
22	**Cyprus**	E & G Economides LLC: Marinella Kilikitas & George Economides	136
23	**Denmark**	Bech-Bruun: Steen Jensen & David Moalem	143
24	**Dominican Republic**	Guzmán Ariza: Fabio J. Guzmán-Saladín	149
25	**Egypt**	Matouk Bassiouny: Omar S. Bassiouny & Malak Habashi	155
26	**Finland**	Dittmar & Indrenius: Anders Carlberg & Jan Ollila	160
27	**France**	Villey Girard Grolleaud: Frédéric Grillier & Daniel Villey	167
28	**Germany**	SZA Schilling, Zutt & Anschütz: Dr. Marc Löbbe & Dr. Stephan Harbarth, LL.M. (Yale)	173
29	**Hungary**	Lendvai Partners: András Lendvai & Dr. Gergely Horváth	180
30	**Iceland**	BBA: Baldvin Björn Haraldsson & Höskuldur Eiríksson	186
31	**Indonesia**	Ali Budiardjo, Nugroho, Reksodiputro: Theodoor Bakker & Herry Nuryanto Kurniawan	193
32	**Ireland**	Dillon Eustace: Lorcan Tiernan & Adrian Benson	200
33	**Italy**	Macchi di Cellere Gangemi: Claudio Visco & Stefano Macchi di Cellere	207
34	**Japan**	Nishimura & Asahi: Masakazu Iwakura & Tomohiro Takagi	215
35	**Kazakhstan**	SIGNUM Law Firm: Liza Zhumakhmetova & Gaukhar Kudaibergenova	224
36	**Luxembourg**	Rutsaert Legal: Quentin Rutsaert	230
37	**Macedonia**	Debarliev, Dameski & Kelesoska Attorneys at Law: Emilija Kelesoska Sholjakovska & Ljupco Cvetkovski	236
38	**Malta**	WH Partners: Ruth Galea & Graziella Grech	243
39	**Mexico**	Nader, Hayaux & Goebel: Yves Hayaux-du-Tilly Laborde & Eduardo Villanueva Ortíz	249
40	**Montenegro**	Moravčević Vojnović i Partneri in cooperation with Schoenherr: Slaven Moravčević & Miloš Laković	255

Continued Overleaf

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Country Question and Answer Chapters:

41	**Netherlands**	Houthoff Buruma: Alexander J. Kaarls & Willem J.T. Liedenbaum	262
42	**Nigeria**	Udo Udoma & Belo-Osagie: Yinka Edu & Ekundayo Onajobi	270
43	**Norway**	Aabø-Evensen & Co Advokatfirma: Ole Kristian Aabø-Evensen & Harald Blaauw	278
44	**Poland**	WBW Weremczuk Bobeł & Partners Attorneys at Law: Łukasz Bobeł & Nastazja Lisek	293
45	**Puerto Rico**	Ferraiuoli LLC: Fernando J. Rovira-Rullán & Yarot T. Lafontaine-Torres	300
46	**Romania**	Pachiu & Associates: Ioana Iovanesc & Alexandru Lefter	307
47	**Russia**	Pen & Paper: Stanislav Danilov	315
48	**Serbia**	Moravčević Vojnović i Partneri in cooperation with Schoenherr: Matija Vojnović & Luka Lopičić	321
49	**Slovakia**	Schoenherr: Stanislav Kovár & Peter Devínsky	329
50	**Slovenia**	Schoenherr: Vid Kobe & Marko Prušnik	336
51	**Spain**	Roca Junyent SLP: Natalia Martí & Xavier Costa	346
52	**Switzerland**	Bär & Karrer AG: Dr. Mariel Hoch & Dr. Dieter Dubs	356
53	**Tanzania**	Abenry & Company, Advocates: Lucy Sondo & Francis Ramadhani	364
54	**Turkey**	Türkoğlu & Çelepçi in cooperation with Schoenherr: Levent Çelepçi & Bürke Şerbetçi	372
55	**Uganda**	ENGORU, MUTEBI ADVOCATES: Robert Apenya & Arnold Lule Sekiwano	378
56	**Ukraine**	CMS Reich-Rohrwig Hainz: Maria Orlyk & Kateryna Soroka	384
57	**United Kingdom**	Slaughter and May: William Underhill	390
58	**USA**	Skadden, Arps, Slate, Meagher & Flom LLP: Ann Beth Stebbins & Thomas H. Kennedy	397
59	**Uzbekistan**	Kosta Legal: Nail Hassanov & Maxim Dogonkin	414

EDITORIAL

Welcome to the tenth edition of *The International Comparative Legal Guide to: Mergers & Acquisitions*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of mergers and acquisitions.

It is divided into two main sections:

Five general chapters. These chapters are designed to provide readers with an overview of key issues affecting mergers and acquisitions, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in mergers and acquisitions in 54 jurisdictions.

All chapters are written by leading mergers and acquisitions lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor Michael Hatchard of Skadden, Arps, Slate, Meagher & Flom (UK) LLP for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.co.uk.

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The Nancy Reagan Defence in 2015: Can a Board Still Just Say No?

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The Nancy Reagan Defence in 2015: Can a Board Still Just Say No?

Six years ago, the board of directors of Airgas Inc. just said no to a takeover bid from Air Products that offered a substantial premium to the company's then trading price. The directors' refusal to redeem the "poison pill" rights plan to allow the Air Products bid to proceed was upheld by the Delaware courts and the bid was defeated. The Airgas board recently agreed to sell the company to Air Liquide of France for more than double the highest price offered by Air Products (even before considering dividends subsequently received by Airgas shareholders). The total shareholder return from that board decision to "just say no" to Air Products' bid far outpaced even the bullish market over the intervening period.

In many jurisdictions, the board of directors of a company subject to a hostile takeover bid is prohibited from taking any actions to "frustrate" the takeover and is limited to offering its opinion to the shareholders as to whether to accept or reject the bid. This is not the case in the United States, where the law empowers the board of directors to "just say no" to a hostile acquirer and to use a variety of defensive tactics to thwart a takeover attempt. Over the course of the past 15 years, however, a maelstrom of change has swept through the corporate governance landscape in the United States. Although the board's expansive legal authority to defend the corporation against a hostile takeover remains unchanged, the practical ability of most boards to "just say no" to a takeover approach has been greatly diminished; the tried-and-true "republican" form of corporate governance – in which shareholders first elected and then relied on a board of directors who were deeply knowledgeable and committed to the corporation they served – has given way to the idea of governance by "democratic" plebiscite. This is the reality, but it is an unfortunate reality. Despite the example of tremendous shareholder benefit by resolute board action in the Airgas situation, current dynamics may result in far fewer Airgas-like victories for shareholders, who today have largely lost the benefit of boards with the sanction and support to make tough decisions [1].

The legal framework in the U.S. regarding directors' duties in responding to hostile takeover bids recognises that it is the role of the board – not short-term speculators or activist investors, and especially not would-be acquirers with an interest in paying the lowest price possible for a corporation – to determine if and when a company should be sold. The power that the law entrusts to the board of directors is significant, but the allocation of responsibility is a sensible one. It is reasonable to believe that a group of directors with deep and thorough knowledge of the company, and subject to fiduciary duties to the company and all of its shareholders, are better positioned than disaggregated shareholders to evaluate the merits of a takeover proposal and decide whether the time is right to sell or whether a proposal fairly values the company. Shareholders have widely dispersed and very different interests, and generally suffer from a variety of free-rider, collective-action and other market realities. Those investors who are heavily concentrated in one company often have interests and time horizons very different from, and often in conflict with, the silent majority of shareholders. In our experience working with boards over many years, directors are almost always committed to doing the right thing for the company and all of its shareholders.

Sadly, despite the fact that U.S. law continues to respect the role of the board and the delicate and sensible balance between shareholders and boards of directors, shareholder activists have succeeded in changing the facts on the ground dramatically over the past 15 years, making it much more difficult for boards to defend and protect companies when they believe that it is the right thing to do.

The Legal Framework

Under the American federal legal system, issues that relate to the manner in which the corporation is governed and the rights of shareholders are matters of state law [2]. More than half of U.S. public companies are incorporated in the state of Delaware. One of the bedrock principles of Delaware law is that corporations are managed by, or under the direction of, a board of directors. It is well-established under Delaware law that, when the directors believe that a hostile takeover bid poses a threat to the corporation, the board may actively resist the hostile takeover bid, consistent with the directors' fiduciary duties to the corporation. This resistance may include adopting a shareholder rights plan (otherwise known as a "poison pill") to ensure that control will not pass to the hostile party without the board having a fair opportunity to respond to the bid. It might also include share issuances to third parties (so-called "white squire" issuances) or perhaps even to an employee stock ownership plan [3], revisions to the target company's by-laws, adoption of employee protections (often referred to as "golden parachutes" or "tin parachutes" in the case of rank-and-file employees), litigation, regulatory action, recapitalisations, acquisitions, and whatever other creative tactics clever directors, managements, bankers and lawyers can devise [4].

The broad legal prerogative described above to resist a hostile takeover bid is well-established under Delaware judicial doctrines, and even more so under the statutory provisions of many other states, which (unlike Delaware) include in their corporate laws constituency statutes (that expressly allow directors weighing takeover bids to take into account the interests of constituencies other than shareholders) [5] and "pill validation" statutes, which

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include in their corporate statutes provisions that expressly permit boards to adopt poison pills which they consider to be in the best interests of shareholders of the corporation.

There are, of course, corporation law and other legal limitations on the board's ability to resist a hostile takeover attempt. The board may not make changes which deny the shareholders their fundamental "franchise" or right to elect directors [6], or which foreclose or preclude the possibility of the hostile bid's success [7], and they may not adopt so-called "scorched earth" tactics that would harm shareholder value, such as giving a favoured bidder an option to buy a "crown-jewel" asset at an unduly advantageous price, where the sale of the asset would diminish the overall value of the corporation. But as long as the board's actions are reasonable and proportionate in relation to a reasonably perceived threat to the corporation (this is the "Unocal" standard) [8], the law gives the target's board fairly wide latitude to fend off a hostile takeover bid.

Many courses and primers on American corporate law stop after the bold proclamation that a board has the ability to "just say no" to a hostile acquirer and fail to consider the practical constraints resulting from the tidal wave of corporate governance changes that has swept through the American corporate landscape in recent years, and which effectively impose the most potent limitation on the ability of a board of directors to fend off a hostile acquirer. As a result of the steep decline in the number of companies with a staggered board and the simultaneous increase in the number of companies that permit their shareholders to call special meetings, a board of directors is much more limited in its ability to put up an effective and prolonged fight when faced with a hostile acquirer than it would have been a few years ago.

Cracks in the Fortress

The board of directors of a company with a staggered board and a shareholder rights plan (either in effect or "on the shelf") is well-positioned to "just say no" and to fend off hostile acquirers proposing inadequate or unfair transactions. At companies with staggered boards, directors are elected to three-year terms, with one-third of the board standing for election each year. A staggered board, therefore, requires a bidder to prevail at two annual meetings in order to take a majority of the seats on the board (as long as the provision implementing the staggered board is properly drafted so as not to be "leaky" [9]). The combination of a staggered board with a shareholder rights plan, which prevents the hostile bidder from being able to bypass the board of directors and complete a hostile tender offer to gain control of the company, presents a formidable defence to a hostile bidder that has not succeeded in convincing the target board to embrace the proposed deal. Because the shareholder rights plan can only be redeemed by the board, and a hostile acquirer must succeed at two annual meetings to obtain a majority of the seats on the board of directors, the only way to get a deal done in the near-term is to work with the board of directors to negotiate a friendly deal. It was this combination of a staggered board and a shareholder rights plan that enabled the Airgas board of directors to fend off Air Products' opportunistic hostile bid.

But the prevalence of these defences has steadily declined at American companies. In 1998, approximately 60% of the S&P 500 had a shareholder rights plan in place; by the end of 2014, only 6% of the S&P 500 had a rights plan in place. This in itself is not all that important because a poison pill can be implemented by the board of directors at short notice without a shareholder vote, and most corporations have poison pills "on the shelf" (this term could mean that they actually have a draft ready to be adopted by the board, but could also mean that they just have a law firm ready to prepare one). Much more significant, however, is the fact that the number of companies with staggered boards has also plummeted over the past decade-and-a-half, with very few large public companies still having one. Unlike a shareholder rights plan, a staggered board has to be implemented in a company's charter (also known as the certificate or articles of incorporation) and so cannot be unilaterally implemented by the board. Following the wave of abusive hostile takeover bids in the 1980s and the IPO boom of the 1990s, at the turn of the millennium most public companies had staggered boards, enabling the board to fend off a hostile bid through two annual meeting cycles. In 1998, 60% of companies in the S&P 500 had staggered boards. By 2005, the number had fallen below 50%. Today, fewer than 10% of S&P 500 companies have staggered boards [10].

This decline in the number of companies with a staggered board has drastically changed the ability of most boards to "just say no" to a hostile acquirer. While, as a legal matter, boards continue to have the authority to resist a hostile bid, as a practical matter, when the entire board can be replaced at the next annual meeting (or even sooner if the company's organisational documents permit stockholders to call a special meeting or act by non-unanimous written consent), the board's ability to "just say no" has a limited shelf life. That period will generally be in the range of three to nine months, depending on when the approach is made and whether, under the target company's organisational documents, its shareholders are allowed to call a special meeting between annual meetings or to act by written consent without a meeting. Unfortunately for long-term value creation at large public companies, the boards of which might hope to fend off the advances of an opportunistic hostile bidder, shareholders have been pushing for changes to corporate organisational documents that would permit shareholders to act immediately (for example, to remove directors and accept a takeover bid) rather than having to wait until the next annual meeting. Activists are pressing to enable shareholders to call special meetings at increasingly lower thresholds (ISS believes the number should be 10%), or even to act by written consent, a particularly pernicious form of corporate ambush that serves no purpose in widely held public companies other than to empower raiders and frighten boards. Stockholders have a right to call special meetings at over 60% of S&P 500 companies and the ability to act by written consent at 29% of the S&P 500 [11]. Activists are continuing to push for these rights at companies where they do not already exist and to strengthen them where they do: during the 2015 proxy season, 19 companies received stockholder proposals related to stockholder ability to call a special meeting, and 35 received proposals related to stockholder ability to act by written consent.

How this sea-change came about is interesting and instructive. For years, shareholders had been passing precatory votes by high majorities asking directors to propose amendments to their companies' charters to eliminate their staggered boards. Until recently, boards of directors were able to effectively ignore their requests with impunity and do what they considered to be right; namely, retain the staggered board as the only way to be able to protect the company in the event of an opportunistic and inadequate hostile bid. Because directors were elected by plurality vote, they were not at risk of not being re-elected unless someone (typically a hostile bidder or shareholder activist) decided to invest in a proxy fight.

Over the past few years, however, almost all public companies moved from plurality voting for boards to election by majority vote, which meant that a director who did not receive a majority of the votes cast was not duly elected and had to resign (typically by corporate policy, even if the director would, by law, "hold over" until a successor was elected). Over 88% of S&P 500 companies

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now have a majority vote standard to elect directors [12]. Large institutional investors supported this shift to majority voting because it "assures that shareowners' votes count and makes directors more accountable to the investors they represent" [13]. In addition, the powerful proxy voting advisory firms ISS and Glass Lewis adopted policies that they would recommend that shareholders withhold their votes from any director if the board did not adequately respond to a shareholder precatory request. Because directors were unwilling to suffer the embarrassment of rejection, this "one-two punch" in effect converted the precatory resolution into a delayed implementation resolution, with boards feeling compelled to accept whatever governance changes the shareholders demanded, even if they had been traditionally areas within the board's purview and even if they honestly disagreed. Over the past few years, this pressure has led to the elimination of poison pills and staggered boards, the ability for shareholders to call special meetings at increasingly lower levels and, increasingly, the ability to act by written consent.

Where are we now?

Traditionally, the American corporate governance system followed a board-centric or "republican" model, where shareholders would elect directors and entrust them to manage the company, holding them accountable at the end of their term if they were dissatisfied. This system evolved and improved over many decades, enhancing independence and accountability, but was fundamentally sound. By contract, the corporate governance changes that have swept through American corporations in recent years have been more of a revolution, shifting power out of the boardroom and into the hands of stockholders. Most of these shareholders are large money managers who are themselves intermediaries, representing the interests of the ultimate savers and investors, but with their own interests. These changes, especially the decline in staggered boards, have limited the ability of the board to say no to a hostile bidder for more than a few months. Although there is some evidence that large responsible institutional investors are growing increasingly concerned at the short-termism that is driving American corporations, for the most important decision the board can make – whether or not to sell the company – a large measure of power has already been shifted out of the board room. This is unfortunate. It is simply not the case that any bid at a premium to the company's then-current market price is in the best interests of a corporation or its shareholders. However, on the first day that a hostile bid is made public, a significant percentage of a company's shares will trade into the hands of merger arbitrageurs who are by definition short-term speculators, and who are willing to sell at any premium, even one that undervalues the company and is not in the company's long-term interests.

This brings us back to Airgas. The acquisition of Airgas this past year by Air Liquide illustrates the benefits that can result from a board of directors with knowledge of the company and industry, a commitment to doing the right thing, and the tools in place to fend off a hostile acquirer. When Air Products made an unsolicited all-cash bid to acquire Airgas for $60 in late 2009, the Airgas board of directors determined that the offer was well below the company's fair value and rejected the offer. For over a year, the Airgas board of directors steadfastly said "no" to overtures from Air Products, which gradually increased from $60 to a final bid of $70 in December 2010. If Airgas had not had a shareholder rights plan, Air Products could have circumvented the Airgas board and taken its offer directly to the shareholders and, without a staggered board, would likely have replaced the entire Airgas board of directors with its own nominees at Airgas's annual meeting in September 2010 (who then could have redeemed the rights plan).

Air Products abandoned its $70 bid after the Delaware Court of Chancery reaffirmed and endorsed "Delaware's long-understood respect for reasonably exercised managerial discretion, so long as boards are found to be acting in good faith and in accordance with their fiduciary duties" and refused to order Airgas to redeem its shareholder rights plan [14]. In November 2015, a little over five years later, Airgas agreed to be acquired by Air Liquide for $143 per share, in cash, more than double the best and final Air Products (even before considering the more than $9 per share of dividends received by Airgas stockholders in the intervening years). If Airgas's board had not had the ability to fend off the hostile Air Products bid and shareholders had reinvested the full $70 received from the sale in the S&P 500, the total shareholder return would have been 88%. For a long-term stockholder who held onto their Airgas shares after Air Products abandoned its bid, the total shareholder return was 143%. Yes, this is just one anecdote but there are many more stories like this, and of course, it is impossible to know how well companies that were forced to sell into inadequate hostile offers may have done if their boards had had the tools to defend them.

As a result of the corporate governance changes which we have described, most notably the decline in the number of staggered boards, most companies today, faced with a hostile bid, would be much more constrained in their ability to resist than Airgas was in 2010. While it remains true that, as a legal matter, boards of American corporations have far more leeway than boards in many other countries to raise up defences and say no to a hostile bidder, in practice there has been something of a global convergence; "just saying no," especially for more than a few months, has become increasingly difficult in the United States. The practical reality is that corporate governance changes have shifted much of the power to decide whether or not to accept a hostile bid to the shareholders, making it more difficult for target boards to defend against an opportunistic and inadequate hostile takeover, for the benefit of all shareholders. In some cases, the board will be able to convince the shareholders to reject what seems to be a premium offer (for example, Perrigo's successful defence of a hostile bid by Mylan earlier this year [15]), but these cases may be increasingly rare and require extreme circumstances where the bidder's credibility and currency raise serious doubts. It remains to be seen what impact this practical erosion of the ability of boards to resist inadequate takeover bids will have on long-term value creation in America and globally.

Acknowledgment

The authors gratefully acknowledge the invaluable assistance of Chelsea N. Darnell.

Endnotes

[1] Full disclosure: our firm represented Airgas in its defence against Air Products and again in its sale to Air Liquide.

[2] Federal securities laws relate primarily to disclosure matters, ensuring that investors have adequate information on which to base an informed vote (although there are some mandatory structural requirements such as those relating to tender offers).

[3] See Brownlee and Bruner, 'The Leveraged ESOP as a Takeover Defense: The Case of Polaroid Corporation', *Journal of M&A Analysis*, Vol. 1, No. 1, 1990; *Aquila Inc. (f/k/a Utilicorp United Inc.) v. Quanta Services Inc. et al*, Del. Chancery (C.A. No. 19497), Decided: May 10, 2002.

[4] When Oracle made its bid for PeopleSoft and threatened to shift all of the target's customers over to Oracle systems

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and cease supporting PeopleSoft software, the target board implemented a "Customer Assurance Programme" providing that if it was taken over and the buyer ceased supporting the software, customers could put their systems back to the target at the company's cost. The matter was settled before the court could rule on whether this was a legitimate response to the takeover bid.

[5] Many states, including New York, Pennsylvania and Michigan, have adopted these statutes, which permit directors to consider a variety of constituencies (including employees, suppliers, customers and creditors) in addition to shareholders when determining what is in the best interest of the corporation.

[6] *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).

[7] *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361 (Del. 1995).

[8] *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

[9] A staggered board would not provide the desired protective effect if, for example, the bidder is able to have the target's shareholders remove directors without cause (not possible by statute in Delaware if the company has a staggered board) or if the shareholders are able to increase the size of the board and elect enough directors to constitute a majority.

[10] Source: Sharkrepellent.

[11] Source: Sharkrepellent.

[12] Source: Sharkrepellent.

[13] Council of Institutional Investors, Majority Voting for Directors, http://www.cii.org/majority_voting_directors.

[14] *Air Products & Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011).

[15] Full disclosure: our firm represented Perrigo.

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