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# Introduction

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Mergers and acquisitions is a subject of continuing and intense scholarly interest. It has a rich history; the history is informed by, and informs, the history of regulation and the relationship between government and industry. The scholarship includes fascinating descriptive inquiries as to how mergers and acquisitions are conducted, when, and why, and who they affect, and in what ways. Normative questions are also asked: should mergers and acquisitions be encouraged or discouraged? Answers to this question turn on the effects of mergers on companies, acquirers, and other market participants, as well as other stakeholders such as employees, customers, and the broader society. The literature on mergers and acquisition is voluminous, and a single *Handbook* cannot be comprehensive, but we hope in this book to cover many of the principal areas of current interest and debate in both the law and practice of mergers and acquisitions. Our goal is to illuminate and describe our understanding of this important field while setting an agenda for future research.

This *Handbook* covers descriptive areas such as: how are deals structured, and why are they structured as they are? What mechanisms do companies use to deter and defeat hostile acquisition attempts, and how effective are these mechanisms? How has legal doctrine, both statutory and judge-made, developed as practices in the world of mergers and acquisitions have changed? When are lawsuits brought, and how often do they succeed? How does U.S. law and practice on mergers and acquisitions compare to law and practice in other countries? There are normative assessments, too, of whether it is desirable to give boards more or less power to resist being taken over, and, more generally, how well litigation works in these contexts, and whether the emergence of ‘shareholder activists’ who, without taking over corporations, attempt to have significant influence on corporate operations, is a good development and how the law should react. Because of the dominant role Delaware plays in merger and acquisition law and practice, Delaware law and practice is this *Handbook*’s principal focus.

The first part, ‘History and Overview’, has three chapters. The first chapter, by Claire A. Hill, Brian J.M. Quinn and Steven Davidoff Solomon, is entitled ‘Mergers and Acquisitions: A Cyclical and Legal Phenomenon’. The chapter traces the history of mergers and acquisitions. Interestingly, mergers and acquisitions have proceeded in waves; the waves are distinct from one another not just in time, but also in the type of transaction that is

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done. The first wave started in the late 1800s, at a time when mergers were only lightly regulated; merger activity, consisting mostly of ‘horizontal’ mergers (mergers within the same industry), created highly concentrated industries, which led to the enactment of antitrust laws limiting such mergers. The next mergers were therefore ‘vertical,’ within a supply chain. These spurred different sorts of regulation, which spurred different sorts of mergers, including mergers that created ‘conglomerates’ and those that were done by ‘financial acquirers’ in the business of acquiring companies. The trajectory is continuing. The sixth wave of mergers ended due to the 2008 financial crisis, but since that time, merger activity has started to recover, and the pace of recovery has been accelerating.

The next chapter in this part is John C. Coates IV’s ‘M&A Contracts: Purposes, Types, Regulation and Patterns of Practice’. This chapter describes the basic purposes of M&A contracts, and shows how the contracts fulfill these purposes; noting that there is comparatively little empirical work on the contents of M&A contracts, Coates outlines a research agenda.

The third chapter in this part is ‘The Market for Corporate Control: Survey of the Empirical Evidence, Estimation Issues, and Potential Areas for Future Research’, by Darius Palia. How are shareholders of companies involved in merger and acquisition transactions affected? Do such transactions add value for shareholders of bidders, targets, both, or neither? This chapter reviews the empirical evidence, and notes that later work casts doubt on early findings that returns to acquirer shareholders seemed to be zero or negative; the chapter then sets forth an agenda for future research, setting out several provocative hypotheses, including that there might be a negative relationship between CEO age and tenure and the quality of acquisitions made by a firm – that is, that older and more experienced CEOs might engage in lower-quality acquisitions.

The second part is on foundational principles of corporate law. The first chapter, by Gordon Smith, is ‘The Modern Business Judgment Rule’. By law, corporations are managed by or under the direction of a board of directors. Courts accord boards considerable deference except in a few stylized contexts, notably those where there is some evidence of self-interest. Courts’ level of scrutiny of decisions is on a continuum: at one end, courts are highly deferential, and at the other, they scrutinize director conduct carefully, requiring a transaction to meet the exacting standards of ‘entire fairness’. Between the two ends of the continuum is an intermediate category. Most M&A cases either fall into an intermediate category or, if they strongly implicate self-interest, are potentially subject to more exacting scrutiny.

Court deference to directors’ decisions takes the form of the ‘business judgment rule’. Smith argues that in M&A cases – cases involving takeover defenses, controlling stockholder transactions, and stockholder

ratifications of otherwise problematic transactions – the Delaware courts have allowed a way back to the business judgment rule; upon reaching the rule, the plaintiff is left with ‘no further arguments’ or ‘an insurmountable burden’. The Delaware courts thereby manage to avoid ‘assuming responsibility for the substance of business decisions’. Instead, the fundamental M&A decision is left with the board.

The next chapter is Charles Whitehead, ‘Equivalence: Form and Substance in Business Acquisitions’. Corporate law sometimes elevates form over substance; for instance, it sometimes treats two otherwise identical transactions – that is, transactions that achieve the same results but do so using different steps – differently depending on how they were structured. A notable example of this is the different treatment of an asset sale followed by a dissolution and a statutory merger. In some states, the latter triggers appraisal rights but the former does not. But both types of transactions might be treated identically for purposes of liability to the dissolving company’s creditors. Many analyses discuss the tension between predictability in transaction structuring and the ‘equitable’ issues presented by overriding predictability in particular cases. This chapter articulates a principled account of how to resolve this tension in particular fact settings. It considers when different treatment might be warranted, ‘assessing different business acquisition forms and their effect on different corporate stakeholders’.

The next part is on Transaction Structuring. Both of the chapters in this part address hot issues in transaction structuring; readers interested in a more general overview should read Coates’s article in Part I of this *Handbook*.

The first chapter, by Robert P. Bartlett, III, is ‘A Founders’ Guide to Unicorn Creation: How Liquidation Preferences in M&A Transactions Affect Start-up Valuation’. ‘Unicorns’ are companies with a valuation greater than one billion dollars. The article provides a variety of reasons why valuations of unicorn companies, and indeed, even other venture capital-funded companies, might not be reliable; the author focuses particularly on one reason, that venture capital investors may not properly value liquidation preferences when pricing their financing.

The next chapter in this part is ‘Addressing Informational Challenges with Earnouts in Mergers and Acquisitions’, by Albert Choi. One obstacle to deal-making is the parties’ difficulty in agreeing on price. The buyer wants to pay less than the seller will accept, often because the seller thinks the business will earn more than the buyer thinks it will earn. A well-known solution to this problem is for the parties to agree that the transaction consideration should consist of a fixed amount paid at closing and a variable amount paid after closing and computed based upon what the business

earn. Choi's chapter discusses how and when earn-outs are used, and the perils that earnout structurers have to address. He also argues that one type of earnout – one paid in stock of the buyer – has underappreciated advantages in reducing information asymmetry.

The next part is on Takeover and Deal Defenses. Companies' advances towards other companies are sometimes unwanted. A company may not want to be acquired, or may not want to be acquired by certain potential acquirers. Or a company may have entered into a deal and it, and its acquirer, may not want that deal to be derailed. This part has three chapters. The first chapter, Jordan Barry, 'Takeover Defenses: The Lay of the Land and Disputed Sign Posts', provides an overview of takeover defenses generally and concludes that, notwithstanding the enormous volume of studies on the subject, there is little consensus on when takeover defenses are used and what effect they have.

The second chapter explains and defends staggered boards. Staggered boards are viewed negatively by many commentators. The argument is that such boards are used by management to entrench itself, warding off potential acquirers and thereby reducing shareholder value. A typical staggered board has three classes. Directors' terms are three years each, and only one class's term ends in any given year, meaning that two election cycles are required to replace a majority of the board – something that a hostile acquirer impeded in its attempts to acquire a company with a poison pill would need to do to get the pill redeemed. Many acquirers might not have the patience to pursue such a strategy. In 'Staggered Boards: Practice, Theory, and Evidence', Simone M. Sepe investigates the issue empirically and concludes that contrary to what many have supposed and what some evidence thus far had seemed to indicate, such boards add value for shareholders. He considers various explanations for this value-adding effect.

The third chapter, by Megan Wischmeier Shaner, is entitled 'Deal Protection Devices: The Negotiation, Protection, and Enforcement of M&A Transactions'. After explaining such devices, which serve to protect an agreed-upon transaction against the advances of another potential acquirer, and the history of their use, Shaner concludes that shareholders may be ill-served by the current trend of giving independent target boards considerable flexibility in negotiating deal protection packages – the result may be to impede 'competition for target corporations and threaten[] stockholders' ability to receive the best possible deal'.

The next part is on Standards of Review. The previous part discussed what companies do to defend against a hostile acquirer or a third party interfering with a previously negotiated transaction. This part discusses what standards of review courts use in assessing whether directors abided by their fiduciary duties in rebuffing, and also agreeing on, deals, as well as,

more broadly, how judicial opinions affect deal practice. The first chapter, by Lawrence A. Hamermesh and Jacob J. Fedechko, is entitled ‘The Role of Judicial Opinions in Shaping M&A Practice’. The authors identify several ways in which judicial opinions affect what transacting parties do. One way is through holdings that describe more and less desirable practices, where the least desirable practices might yield director liability. For instance (and famously), after the opinion in *Smith v. Van Gorkom* implied that a seller’s board should obtain a fairness opinion to satisfy its fiduciary duty of care in considering a sale of the company, almost all sellers began obtaining such opinions. Other ways practice is shaped are through opinions allowing particular responses to bids and particular deal provisions, and interpreting provisions in agreements in particular ways. In these cases, Delaware does not necessarily require particular provisions or terms, but, by casting them in a favorable light, they soon become widely adopted.

The second chapter, ‘The Reconfiguring of *Revlon*’, by Lyman Johnson, discusses the history and present status of the *Revlon* doctrine, named after the 1986 case *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). When control of a company is about to change, the board’s duties shift, such that it becomes an ‘auctioneer’, charged with obtaining the highest price reasonably available for the shareholders. When *Revlon* is not triggered, though, the board is given considerable deference in the decision to enter into an M&A transaction (or not to do so). *Revlon*’s focus is, apparently, on both a time horizon – short term rather than long term – and on the appropriate set of interests to be (exclusively) taken into consideration and indeed, maximized – that of shareholders. By contrast, in the normal course, directors would not be second guessed for having a longer time horizon, nor would they be called to account for not exclusively maximizing shareholder interests. Johnson concludes that:

grave reservations about whether and when corporate directors should be required to pursue short-term goals finds useful cover in sustained judicial murkiness over the boundaries of *Revlon*. Only if Delaware courts resolve the underlying issue of corporate purpose more generally will *Revlon* either be fitted into the larger body of Delaware law or continue to stand uncomfortably to the side as a doctrinal loner of diminished significance.

The last chapter in this part is Fernán Restrepo and Guhan Subramanian, ‘Freezeouts: Doctrine and Perspectives’. A freezeout is a transaction in which a controlling shareholder purchases the remaining shares held by the minority shareholders. Freezeouts involve a powerful reason for court scrutiny: that the controlling shareholder may be taking advantage of the minority shareholders, buying out their shares on the cheap. Freezeouts

can be accomplished through a merger, or through a two-step transaction, a tender offer succeeded by a merger. The original cases required freezeouts to meet the exacting 'entire fairness' review, albeit sometimes shifting the burden to plaintiffs to show that a transaction was not entirely fair if the defendants demonstrated that they had used certain procedural protections. The law eventually developed to allow both sorts of freezeouts to avoid the entire fairness review altogether, again if certain procedural protections are employed. But there has not thus far been a wholly unified standard – one set of procedural protections which, if used, would guarantee a freezeout in whatever form business judgment deference rather than an entire fairness review. The authors recount this history and review the empirical evidence. They then argue that the courts' move towards allowing business judgment deference for freezeouts is appropriate, but that a unified standard is needed, and that the standard should be the one used for merger freezeouts: that the transaction was negotiated and approved by an independent special committee, and that it was approved by an affirmative vote of the majority of the minority.

The next part concerns Litigation. Litigation in the M&A context has been strongly criticized. Lawsuits are brought with respect to almost every public M&A transaction; the criticism is that these suits may be a 'tax' on transactions, providing little (if any) benefit to shareholders. The first chapter in this part, 'Settlements and Fees in Merger Litigation', by Sean J. Griffith, uses these criticisms as backdrop, but notes that 'the Court of Chancery has . . . been given a free hand to implement new approaches to address the perceived excess in merger litigation'. He discusses various approaches the Court might consider, including 'rejecting low value settlements as a matter of course', presumptively rejecting disclosure-only settlements (settlements that do not include monetary relief) and other settlements that do not offer a quantifiable benefit to the corporation. Griffith also discusses the appropriate scope of releases in M&A litigation, assessing the argument that these releases should be more tailored to the value received by the shareholder class. He concludes by noting that whatever form the court's reforms take, 'we should expect greater judicial scrutiny of settlement and fees in merger litigation'.

The second chapter in this part, David H. Webber, 'Lead Plaintiffs and Lead Counsel in Deal Litigation', offers a more optimistic assessment of the value of deal litigation. In class actions, lead plaintiffs are chosen by courts. Reviewing the evidence, Webber finds that courts perform well in selecting lead plaintiffs and that lead plaintiffs select high quality law firms. Markets are aware of better and worse quality in these respects, responding positively to 'the filing of suits by top firms and negatively to the filing of suits by poor quality firms'. The evidence suggests, Webber argues, that

better plaintiffs and better lawyers ‘correlate with better outcomes for shareholders in deal cases.’

The next part covers Statutory Issues. One of the chapters discusses a particularly hot topic in recent times: appraisal. The other discusses one of the most important federal laws governing mergers and acquisitions, the Williams Act.

The chapter on appraisal, ‘The Deterrence Value of Stockholder Appraisal’, is by Charles R. Korsmo and Minor Myers. Appraisal rights are the rights shareholders in a merged company have to get a court to consider whether the consideration they received for their shares in the merger constituted ‘fair value’. Appraisal actions had until recently been quite rare; they were expensive to bring and took a significant amount of time to resolve. But more recently, ‘appraisal arbitrageurs’ have begun pursuing appraisal far more frequently, even raising money precisely to buy stock on which they could make appraisal claims. The practice has been quite controversial. Some commentators have argued that it impedes beneficial transactions. The authors disagree, arguing that the appraisal remedy is very valuable, potentially deterring abusive transactions, and that appraisal arbitrage itself is ‘in fact essential to achieving the corporate governance purposes of appraisal’.

The Williams Act was adopted in 1968, as a response to the ‘Saturday Night Special’ – tender offers open only for a very short period of time, made without target management’s approval or even knowledge, and without much in the way of disclosure. Among other things, the Williams Act requires the filing of a Schedule 13D within ten days of the acquisition of more than 5 percent of the target’s stock, and the filing of a Schedule TO upon launching a tender offer for a target. In ‘Tender Offers and Disclosure: The History and Future of the Williams Act’, Christina M. Sautter traces the history of the Williams Act, discusses current issues and controversies, considers how well the Williams Act works given our present world, and sets forth various possibilities as to how the Act might be modified to meet present-day challenges.

The line between shareholder activism and M&A is blurring. Present-day shareholder activists want to influence the direction of a company; while they tend to do so through means other than takeovers, recently, the Pershing Square hedge fund teamed up with Valeant Pharmaceuticals to support Valeant’s (ultimately failed, but highly profitable) attempt to take over another pharmaceutical company, Allergen. This part, on Shareholder Activism, has two chapters. One is by then-Vice Chancellor Donald F. Parsons, Jr. of the Delaware Chancery Court and Jason S. Tyler. Entitled ‘Activist Stockholders, Corporate Governance Challenges, and Delaware Law’, the chapter discusses and reviews the recent history

of shareholder activism. Shareholder activists have prompted considerable debate, reviled by some and seen as needed correctives by others. The chapter argues that Delaware courts' role is not to take sides, but instead, 'to safeguard the debate'.

Claire Hill and Brett McDonnell's chapter 'Short- and Long-Term Investors (and Other Stakeholders Too): Must (and Do) Their Interests Conflict?' considers a closely related debate: to what extent corporations' short- and long-term interests really differ. One big criticism of shareholder activists is that they are short-term investors, attempting to influence companies to get and distribute quick cash, and discourage investments that might have longer-term payoffs. But on the orthodox academic view, short-term investors should not undervalue longer-term prospects: since a corporation's value is determined by its future cash flows, that a project's projected cash flows are in the future, even far in the future, should not by itself make it worth less to a corporation. The typical response by those who do see a difference between the short and long term is typically not a principled one; rather, the response is to simply argue that in the real world, a short-term outlook does cause corporations to excessively discount the long term. They do not explain why stock prices would not embed the expectation of profits in the moderate to long term.

Whether or not shareholders have an interest in corporate projects with a long-term time horizon, society probably has some interest in at least some such projects, notably including the development of drugs to cure disease. The authors engage this debate and consider reasons why, even within an economic framework, the short term and the long term might differ. The authors also consider how other stakeholders might fit into the debate. Those favoring short-term payoffs that limit a company's long-term investments are generally shareholders; longer-term investments may benefit other stakeholders as well, including employees and the greater society.

The last part is on Comparative Perspectives. The two chapters in this part consider M&A law and practice in two countries: Canada and India. The chapter on Canada, Christopher Nicholls, 'Canadian M&A: A Comparative Perspective', surveys Canadian M&A law and compares it to U.S. law. The author concludes that while Canadian law is strongly influenced by, and in some respects resembles, U.S. law, it has more differences than is commonly appreciated, notably as concerns 'the uniquely Canadian use of the plan of arrangement to structure friendly acquisitions' and 'the prominent and decidedly pro-shareholder role historically played by Canadian securities regulators in hostile bids'. The last chapter in this part is Afra Afsharipour, 'Legal Transplants in the Law of the Deal: M&A Agreements in India'. Much has been written about the promise and perils

of transplanting law from one jurisdiction (a developed country jurisdiction) to another (typically, an emerging country.) This chapter addresses transplantation of one sort of 'private' law – the law of the deal, set forth in parties' private agreements as entered into in the shadow of the broader regulatory system. Afsharipour compares U.S. and Indian transactional contracting practices, concluding that many U.S. mechanisms are now being used in Indian transactions. She describes some advantages of this transplantation, such as the reduction of transaction costs, and the fact that the provisions may be good solutions for common transacting problems. She notes, though, that there are disadvantages as well, such as missed opportunities for experimentation, and the use of provisions not ideally suited for the local conditions in which they are being utilized.

As we complete this Introduction in the spring of 2016, the M&A market is of immense importance in our capital markets. In 2015, there were nearly \$4 trillion worth of M&A deals worldwide, and M&A activity in 2016 is continuing at a brisk pace albeit at a somewhat reduced level. This shows the significant impact M&A has on our markets, our economy, and society more broadly. Yet, while M&A plays an important role in our economy there is much that we still do not understand about this field. The law itself also continues to try and keep pace with the changing structure of our capital markets, changes wrought in part by furious innovation and technological change. This *Handbook* provides breadth and depth on many of the major topics at issue in Mergers and Acquisitions today. The book is designed to not only impart considerable knowledge in this area, but also to set an agenda for future research. We hope that this book is only a part of your continuing exploration of the subject.

