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## Reevaluating Shareholder Voting Rights in M&A Transactions

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# REEVALUATING SHAREHOLDER VOTING RIGHTS IN M&A TRANSACTIONS

AFRA AFSHARIPOUR\*

## *Introduction*

Shareholder voting plays a central role in corporate governance. Yet, for many public company acquisition transactions, only the target firm's shareholders can exercise voting rights under corporate law. The lack of voting rights for shareholders of the acquiring (or bidder) firm is potentially problematic given anecdotal and empirical evidence that a large percentage of public company acquisitions involve negative returns for bidder shareholders. Recent research shows that compulsory shareholder voting reduces the problem of bidder overpayment. Despite this evidence, the response in corporate law has been muted. This article reviews the empirical and legal literature on the role of bidder shareholders in acquisitions and suggests ways that compulsory voting can be implemented in large public company acquisitions to reduce the overpayment problem.

The popular press is replete with stories of bidder overpayment and poorly performing corporate acquisitions. The disastrous combination of firms such as America Online and Time Warner<sup>1</sup> or the problem-laden

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1. See ROBERT F. BRUNER, DEALS FROM HELL: M&A LESSONS THAT RISE ABOVE THE ASHES 265–91 (2005) (providing a detailed description of the AOL-Time Warner transaction as "possibly the most notorious" deal from hell); Tim Arango, *How the AOL-Time Warner Merger Went So Wrong*, N.Y. TIMES (Jan. 11, 2010), <http://www.nytimes.com/2010/01/11/business/media/11merger.html> (reporting that the 2000 deal valued the combined firm at \$350 billion, and that ten years later the combined value of the companies, which have since separated, was about one-seventh of their combined value on the day of the merger); Steven Davidoff Solomon, *A Slow Demise for a Deal from Hell*, N.Y. TIMES DEALBOOK (Apr. 29, 2009, 11:21 AM), <http://dealbook.nytimes.com/2009/04/29/spins-splits-and-time-warners-deal-from-hell/> ("That the AOL-Time Warner deal was one of the worst, if not the worst, in history, is a sad truism for the markets and mergers and acquisitions classrooms everywhere.").

acquisition of Countrywide by Bank of America<sup>2</sup> are often touted as examples of acquisitions that proved to be terrible deals for the acquirer. A company engrossed in an acquisition frenzy can end up overpaying for its target by significant amounts. For example, in September 2011, Hewlett Packard (“HP”), a venerated Silicon Valley firm, agreed to buy British company Autonomy for \$10.3 billion—a decision that was controversial with HP shareholders who claimed that HP was overpaying for Autonomy.<sup>3</sup> Only a year later, HP announced a write-down of \$8.8 billion related to the Autonomy acquisition with over \$5 billion due to accounting irregularities at Autonomy.<sup>4</sup> Not only did HP fail to realize the gains it expected from the Autonomy acquisition, but the transaction led to various lawsuits between HP and Autonomy management, and resulted in a large securities class action suit against HP.<sup>5</sup> The Autonomy deal was just one in a string of questionable acquisitions by HP during a busy acquisition spree.<sup>6</sup>

“[A] bad deal—whether the failure is rooted in the concept [i.e., the ‘logic of the deal,’ that is, the business justification for the proposed acquisition], the price, or the execution—is probably the fastest legal means of destroying [the company’s] value.”<sup>7</sup> A bad acquisition can result not only in a lower share price, but also loss of jobs as the acquirer suffers in the aftermath of a failed integration and the potential acquisition of massive problems that may not have been adequately addressed at the target entity. For example, Bank of America’s string of questionable empire-building acquisitions, including the \$4 billion acquisition of Countrywide, saddled the firm with significant problems, including an estimated \$40 billion in mortgage-related losses, legal expenses, and settlements.<sup>8</sup> In the years

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2. See *Strife of Brian*, *ECONOMIST* (Sept. 17, 2011), <http://www.economist.com/node/21529060> (recounting the troubles that were brought on Bank of America as a result of a string of questionable empire-building acquisitions, including the \$4 billion acquisition of Countrywide that saddled the bank with an estimated \$30 billion in mortgage-related losses).

3. See Richard Waters & Peter Campbell, *HP Enterprise Seeks to End Autonomy Saga with Software Sale*, *FIN. TIMES* (Sept. 2, 2016), <https://www.ft.com/content/e657857a-7113-11e6-a0c9-1365ce54b926>.

4. *Id.*

5. *Id.*

6. See Clive Longbottom, *HP: Where Next for the Troubled Silicon Valley Giant*, *COMPUTERWEEKLY.COM* (Apr. 30, 2015), <http://www.computerweekly.com/feature/HP-Where-next-for-the-troubled-Silicon-Valley-giant>.

7. Ken Smith, *The M&A Buck Stops at the Board: Directors Are Learning Fast How to Screen Out No-Win Deals*, *MERGERS & ACQUISITIONS: DEALMAKER’S J.*, Apr. 1, 2006, at 48, 49, 2006 WLNR 5570070.

8. See Ben Protess, *Tallying the Costs of Bank of America’s Countrywide Nightmare*, *N.Y. TIMES DEALBOOK* (Oct. 25, 2012, 5:19 PM), <http://dealbook.nytimes.com/2012/10/25/>

following the acquisitions, Bank of America ended up selling some of the businesses that it acquired and laying off tens of thousands of employees.<sup>9</sup>

Empirical evidence backs up the story of disastrous acquisition decisions. Studies have found that, in general, many large-scale acquisitions of public companies by other public companies result in significant losses for shareholders of acquiring firms.<sup>10</sup> Not only do bidder shareholders lose, but the losses from the worst-performing deals can be staggering. For example, a study of deals from 1998 to 2001 finds that bidder shareholders lost 12% for every dollar spent on acquisitions, for a total of \$240 billion.<sup>11</sup> Moreover, the study suggests that this is wealth destruction on an aggregate scale and not just a wealth transfer to target shareholders from bidder shareholders.<sup>12</sup>

Studies suggest two non-mutually exclusive explanations for the overpayment problem: agency problems and behavioral biases. Acquisitions tend to highlight conflicts of interest between managers and shareholders in large public corporations.<sup>13</sup> The acquirer's management can benefit significantly from acquisitions through increased power, prestige, and additional compensation.<sup>14</sup> Acquisitions can also be significantly

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tallying-the-costs-of-bank-of-americas-countrywide-nightmare/; Jessica Silver-Greenberg & Susanne Craig, *Bank of America Settles Suit over Merrill for \$2.43 Billion*, N.Y. TIMES DEALBOOK (Sept. 28, 2012, 8:49 AM), <http://dealbook.nytimes.com/2012/09/28/bank-of-america-to-pay-2-43-billion-to-settle-class-action-over-merrill-deal/>.

9. See E. Scott Reckard, *BoFA Targets Highly Paid Investment Bankers in Latest Layoffs*, L.A. TIMES (May 2, 2012), <http://articles.latimes.com/2012/may/02/business/la-fi-0502-bank-america-layoffs-20120502>; Deon Roberts, *Bank of America Head Count Almost Down to 2008 Levels*, CHARLOTTE OBSERVER (Mar. 6, 2016), <http://www.charlotteobserver.com/news/business/banking/article64138397.html>.

10. See, e.g., Ulrike Malmendier & Geoffrey Tate, *Who Makes Acquisitions? CEO Overconfidence and the Market's Reaction*, 89 J. FIN. ECON. 20, 34, 42 (2008).

11. Sara B. Moeller et al., *Wealth Destruction on a Massive Scale? A Study of Acquiring-Firm Returns in the Recent Merger Wave*, 60 J. FIN. 757, 757 (2005) [hereinafter Moeller et al., *Wealth Destruction*].

12. See *id.* at 758-59.

13. Beginning with Berle and Means' seminal work, agency cost problems have long dominated debates in U.S. corporate law about the conflicts between shareholders and managers. See ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 4-5, 119-25 (1932); Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323, 323, 328 (1986); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

14. See Leonce Barger et al., *Why Do Private Acquirers Pay So Little Compared to Public Acquirers?*, 89 J. FIN. ECON. 375, 376 (2008). For more on "empire building," see Christopher Avery et al., *Why Do Managers Undertake Acquisitions? An Analysis of*

affected by various behavioral biases such as management overconfidence about the value of the deal (i.e. the “hubris hypothesis”) or management overestimation and overoptimism regarding its ability to execute the deal successfully.<sup>15</sup>

Neither the right to sell nor the right to sue effectively addresses the bidder overpayment problem and the underlying factors contributing to it. Selling serves as a weak monitoring mechanism for bidder stockholders who often can only sell their shares after the share price has fallen following announcement of an acquisition transaction.<sup>16</sup> Even the specter of a share drop following an acquisition announcement does little to deter bidder management given weaknesses in the market for corporate control.<sup>17</sup> Suing is similarly unattractive for bidder shareholders. “Suing generally has very large transaction costs: legal fees are high, acquiring information (for example, discovery) is costly, and the judicial system moves slowly.”<sup>18</sup> More important with respect to bidder shareholders, the barriers to a successful suit are quite high given that fiduciary duty cases by bidder shareholders will generally be subject to business judgment review.<sup>19</sup> Moreover, the types of soft conflicts tied to overpayment, as identified by the finance literature, are not the clear conflicts that often receive the attention of plaintiffs’ lawyers and thus the courts.

Is it time to reassess the right to vote? Shareholder voting has long been viewed as a way of “reducing managerial agency costs and maintaining director accountability.”<sup>20</sup> As the Delaware court famously noted in

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*Internal and External Rewards for Acquisitiveness*, 14 J.L. ECON. & ORG. 24, 24–28, 42 (1998); Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 627–28 (1989); John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer’s Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1167–69, 1224–29, 1269–80 (1984) [hereinafter Coffee, *Regulating*]; John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 29 (1986).

15. See Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197, 212 (1986); see also RICHARD H. THALER, *THE WINNER’S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE* 50–62 (1992); Black, *supra* note 14, at 601–05, 624; Mark L. Sirower & Mark Golovcsenko, *Returns from the Merger Boom*, MERGERS & ACQUISITIONS: DEALMAKER’S J., Mar. 1, 2004, at 34, 2004 WLNR 18181954; Richard H. Thaler, *Anomalies: The Winner’s Curse*, 2 J. ECON. PERSP. 191, 193–201 (1988).

16. See Paul H. Edelman et al., *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1367 (2014).

17. See *id.*

18. *Id.* at 1375.

19. See *id.* at 1375 & n.4.

20. Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail*

*Blasius*, “[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”<sup>21</sup> Nevertheless, as discussed in Part II, in the U.S., management can easily avoid the shareholder vote for bidder shareholders in acquisition transactions. The fact that acquirers have the flexibility to structure their transactions to avoid the shareholder vote also makes it challenging to empirically study the effect of bidder shareholder votes on acquisitions in the U.S. Recent studies, however, have attempted to address the value of bidder shareholder voting in the U.S.<sup>22</sup> In addition, an important, recent study has addressed the value of voting on acquisitions, looking at the U.K. market where shareholder voting on large acquisitions is mandatory and binding under the U.K. listing rules.<sup>23</sup> As discussed in Part III below, the study of acquisitions made by U.K. companies between 1992 and 2010 shows that mandatory acquirer shareholder voting increases firm value with results indicating that with mandatory voting U.K. shareholders gained \$13.6 billion over 1992–2010 in aggregate (+\$41 million on average), while without voting, U.K. shareholders lost \$3 billion in aggregate. Moreover, the results of the study suggest that mandatory voting, which cannot be avoided by acquirer CEOs in the U.K. as it can be in the U.S., changes the incentive of acquirers and “imposes a constraint on the price that CEOs and boards can offer” in transactions subject to mandatory voting.<sup>24</sup>

There are several ways to achieve voting rights for bidder shareholders, including private ordering through changes in the corporate contract, or changes in stock exchange rules akin to the requirements imposed by the listing rules in the U.K. Of course, such corporate governance proposals may take years to have an actual impact, and there may be political and economic reasons for stock exchanges to resist great shareholder voting rights. Nevertheless, given fundamental changes in the shareholder base of U.S. firms, voting in significant acquisitions may be more palatable now than ever.

This article proceeds as follows. Part I summarizes the bidder overpayment problem and the empirical explanations for overpayment: agency problems and behavioral biases. Part II explains common

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*Investor*, MINN. L. REV. (forthcoming 2017) (manuscript at 4-5), <https://ssrn.com/abstract=2972838> [hereinafter Fisch, *Standing Voting Instructions*].

21. *Blasius, Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988).

22. See *infra* Section III.A.

23. Marco Becht et al., *Does Mandatory Shareholder Voting Prevent Bad Acquisitions?*, 29 REV. FIN. STUD. 3035, 3037 (2016).

24. *Id.* at 3064.

acquisition deal structuring and how such structuring limits or eliminates the voting rights of bidder shareholders. Part II then provides a brief overview of why the shareholders' rights to sell or sue do not provide sufficient protection to bidder shareholders nor are useful checks on the reasons for bidder overpayment. Part III describes the empirical literature on voting and bidder overpayment, including recent literature that strongly suggests that mandatory voting imposes constraints on bidder management and can serve as a deterrent to large, value-destroying acquisitions. Part III then examines the arguments for shareholder voting in public company acquisitions and ways to achieve voting rights. Part IV concludes.

### *I. The Bidder Overpayment Problem and Its Roots*

Empirical studies commonly find that acquisition transactions, particularly significant transactions involving publicly traded targets and buyers, result in losses for bidder firms and their shareholders. Section A below briefly summarizes the overpayment literature. Sections B examines the two leading explanations for bidder overpayment. Studies have generally attributed overpayment to managerial agency costs (such as personal benefits in the form of increased compensation for management) and behavioral biases (such as ego and hubris) of bidder management.

#### *A. The Bidder Overpayment Problem*

Finance scholars have noted that “[e]xtensive empirical evidence shows that a large percentage of transactions involve negative returns for acquirer shareholders and that the losses from the worst performing deals are very large.”<sup>25</sup> Initially, the examination of whether bidder shareholders win or lose in acquisitions was mixed.<sup>26</sup> Some early studies on the wealth effects of acquisitions suggest that bidder shareholders benefit or remain neutral from acquisitions, while other studies report losses.<sup>27</sup> A significant body of more recent empirical studies find, however, evidence that many, although

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25. *Id.* at 3036.

26. For an overview of the early literature on bidder performance in M&A transactions, see generally Afra Afsharipour, *A Shareholders' Put Option: Counteracting the Acquirer Overpayment Problem*, 96 MINN. L. REV. 1018 (2012) [hereinafter Afsharipour, *Shareholders' Put Option*].

27. See generally Robert F. Bruner, *Does M&A Pay? A Survey of Evidence for the Decision-Maker*, 12 J. APPLIED FIN. 48 (2002) (surveying over 100 studies published from 1971 to 2001 on the results to shareholders of M&A transactions and finding that bidder shareholders essentially break even).

clearly not all, acquisitions destroy value for long-term bidder shareholders.<sup>28</sup>

Bidder overpayment is particularly acute in the case of takeovers of publicly traded targets by publicly traded acquirers.<sup>29</sup> A survey of the empirical literature on takeovers of U.S. targets from 1980 to 2005 finds that announcement-period cumulative average abnormal stock returns for bidder shareholders are close to zero for the overall sample of studies, with 49% of bidders having negative cumulative abnormal stock returns.<sup>30</sup> For bidder shareholders, acquisitions of large public targets by public company bidders represent a “worst-case scenario” with average acquirer announcement-period cumulative abnormal returns of a significant loss of 2.21%.<sup>31</sup>

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28. See Gregor Andrade et al., *New Evidence and Perspectives on Mergers*, 15 J. ECON. PERSP. 103, 110–11 (2001); Christa H. S. Bouwman et al., *Market Valuation and Acquisition Quality: Empirical Evidence*, 22 REV. FIN. STUD. 633, 636 (2009); Jarrad Harford et al., *The Sources of Value Destruction in Acquisitions by Entrenched Managers*, 106 J. FIN. ECON. 247, 247–48, 260 (2012); Tim Loughran & Anand M. Vijh, *Do Long-Term Shareholders Benefit from Corporate Acquisitions?*, 52 J. FIN. 1765, 1773–89 (1997); Sara B. Moeller et al., *Firm Size and the Gains from Acquisitions*, 73 J. FIN. ECON. 201, 202, 226 (2004) [hereinafter Moeller et al., *Firm Size*]; Moeller et al., *Wealth Destruction*, *supra* note 11, at 781; Gunther Tichy, *What Do We Know About Success and Failure of Mergers?*, 1 J. INDUSTRY COMPETITION & TRADE 347, 366–68 (2001). Some scholars argue that acquisition activity is driven by overvalued stock and that acquisitions by acquirers with overvalued stock can benefit the acquirer’s shareholders in the long run, as long as the target firm’s stock is less overvalued. Andrei Shleifer & Robert W. Vishny, *Stock Market Driven Acquisitions*, 70 J. FIN. ECON. 295, 301–02 (2003). Other scholars challenge this proposition, finding that “overvalued acquirers often significantly overpay for the targets they purchase” and that such “acquisitions do not produce the necessary synergy gains.” Fangjian Fu et al., *Acquisitions Driven by Stock Overvaluation: Are They Good Deals?*, 109 J. FIN. ECON. 24, 25 (2013). Moreover, Fu et al. also find that “[o]vervalued acquirers incur significantly worse stock returns during the five years following acquisitions than the control firms that did not engage in mergers” and also experience “significant deterioration in operating performance”. *Id.* at 26.

29. See Harford et al., *supra* note 28, at 247–48. Studies suggest that private acquirers experience better post-acquisition performance than public acquirers because of lower agency problems. Andrey Golubov & Nan Xiong, *Why Do Private Acquirers Outperform Public Acquirers?* 26–27 (European Corp. Governance Inst. Working Paper Series in Fin., Paper No. 482/2016), <https://ssrn.com/abstract=2834805>.

30. Sandra Betton et al., *Corporate Takeovers*, in 2 HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE 291, 407 (B. Espen Eckbo ed., 2008).

31. *Id.* There is some evidence that indicates that certain acquirers, companies such as Cisco and Berkshire Hathaway, tend to be very good at acquisitions and the performance of the best acquirers persists from deal to deal, while bad acquirers continue to perform poorly.



Empirical evidence suggests that the losses suffered by bidder shareholders in the largest and worst-performing deals are very significant.<sup>32</sup> The studies by Moeller et al. indicate that managers of large firms pay more for acquisitions, and that premiums paid to targets are larger when the acquirer is larger.<sup>33</sup> Other studies find that “the *relative* size of the target to the acquirer is more important for acquirer shareholder value” and that acquirer shareholder returns are better when the bidder purchases a small firm versus when it attempts “mergers of equals or transformational M&A deals.”<sup>34</sup>

### *B. What Explains Bidder Overpayment? Agency Costs & Behavioral Biases*

Studies identify two non-exclusive explanations for the bidder overpayment problem: agency problems and behavioral biases.

#### *1. Agency Costs*

Both legal and finance scholars have pointed to agency costs in explaining bidder overpayment.<sup>35</sup> Acquisitions highlight divergent shareholder-manager incentives and provide an opportunity for managers to obtain personal gain at the expense of shareholders. Michael Jensen’s free cash flow hypothesis, for example, theorized that equity overvaluation allows “managers [to] realize large personal gains from empire building and predict[ed] that firms with abundant cash flows but few profitable investment opportunities are more likely to make value-destroying acquisitions than to return the excess cash flows to shareholders.”<sup>36</sup> Several studies support Jensen’s theory and provide evidence that the acquirer’s management can benefit significantly from acquisitions through increased power, prestige, and additional compensation.<sup>37</sup>

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See generally Andrey Golubov et al., *Extraordinary Acquirers*, 116 J. FIN. ECON. 314 (2015).

32. See Moeller et al., *Firm Size*, *supra* note 28, at 202, 226; Moeller et al., *Wealth Destruction*, *supra* note 11, at 781.

33. See Moeller et al., *Firm Size*, *supra* note 28, at 202, 226.

34. Eliezer M. Fich et al., *Large Wealth Creation in Mergers and Acquisitions 2–3* (Aug. 8, 2016) (AFA 2013 San Diego Meetings Paper), <https://ssrn.com/abstract=2020507> or <http://dx.doi.org/10.2139/ssrn.2020507>.

35. See, e.g., Black, *supra* note 14, at 627-28; Coffee, *Regulating*, *supra* note 14, at 1167–69, 1224–29; Jensen, *supra* note 13, at 323; Ronald W. Masulis et al., *Corporate Governance and Acquirer Returns*, 62 J. FIN. 1851, 1852 (2007).

36. Masulis et al., *supra* note 35, at 1852 (citing Jensen, *supra* note 13).

37. See Barger et al., *supra* note 14, at 376; Yaniv Grinstein & Paul Hribar, *CEO Compensation and Incentives: Evidence from M&A Bonuses*, 73 J. FIN. ECON. 119, 121

Several studies point to CEO compensation as the motive behind acquisitions, particularly those that lead to overpayment. For example, a study by Jarrad Harford and Kai Li finds that CEOs benefit personally from making acquisitions even when such acquisitions have poor outcomes for shareholders.<sup>38</sup> These acquisitions may provide the board and the CEO a “natural opportunity” to increase the CEO’s compensation since the increase in firm size and operations allows “the CEO to argue for more pay and for pay that is less sensitive to performance for the first few years of the acquisition.”<sup>39</sup> Others have similarly argued that CEO compensation, rather than shareholder value creation, is likely the primary reason for acquisitions, even for overvalued acquirers.<sup>40</sup> For example, Fu et al. find that “acquirer CEOs in overvaluation-driven acquisitions obtain substantial pecuniary benefits following these transactions, specifically large, new restricted stock and option grants.”<sup>41</sup> The study also finds that the increases in CEO compensation “often outweigh the relatively small decreases in the value of the CEO’s equity holding in the acquiring firm.”<sup>42</sup>

From a corporate governance perspective, studies indicate that acquisitions made by entrenched management destroy the most value for bidder shareholders.<sup>43</sup> Studies suggest that in firms with significant takeover defenses, managers can “make unprofitable acquisitions without facing a serious threat of losing corporate control.”<sup>44</sup> Moreover, in firms with overvalued stock, studies have found that acquiring firms with “weak governance structures prior to their acquisition attempts” tend to significantly overpay for the companies they buy and that such acquisitions do not produce the intended synergy gains.<sup>45</sup> Researchers have identified

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(2004) (showing that CEOs who have more power to influence board decisions receive significantly larger M&A bonuses, but these bonuses are not related to deal performance); see also Jarrad Harford & Kai Li, *Decoupling CEO Wealth and Firm Performance: The Case of Acquiring CEOs*, 62 J. FIN. 917, 919 (2007). For more on “empire building,” see sources cited *supra* note 14.

38. See Harford & Li, *supra* note 37, at 919; see also Richard T. Bliss & Richard J. Rosen, *CEO Compensation and Bank Merger*, 61 J. FIN. ECON. 107, 108 (2001) (finding that CEO compensation in bank mergers increases even if the merger causes the acquirer’s stock price to decline).

39. Harford & Li, *supra* note 37, at 918.

40. See Fu et al., *supra* note 28, at 25–26.

41. *Id.* at 26.

42. *Id.*

43. See, e.g., Masulis et al., *supra* note 35, at 1853.

44. *Id.* at 1854.

45. Fu et al., *supra* note 28, at 26.

several factors for value destruction by entrenched management. Per two recent studies, entrenched bidder management (1) disproportionately avoids private targets, which have been shown to be associated with value-creation;<sup>46</sup> (2) tends to not pay with stock when buying a private company target, thus avoiding the governance benefits that would otherwise accrue from creating a blockholder in the bidder; and (3) tends to both overpay and acquire low-synergy targets.<sup>47</sup>

## 2. Behavioral Biases

Behavioral biases may play an important role in corporate transactions.<sup>48</sup> Acquisitions, in particular, can be affected by management overconfidence about the value of the deal (i.e. the “hubris hypothesis”), management’s overestimation of and overoptimism regarding its ability to execute the deal successfully, and management’s desire to win or sunk cost biases.<sup>49</sup>

Several studies have empirically tested the role of management biases in acquisition decisions. In Mathew L.A. Hayward and Donald C. Hambrick’s examination of 106 large acquisitions, they find “losses in acquiring firms’ shareholder wealth following an acquisition, and the greater the CEO hubris

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46. See Micah S. Officer, *The Price of Corporate Liquidity: Acquisition Discounts for Unlisted Targets*, 83 J. FIN. ECON. 571 (2007).

47. See Harford et al., *supra* note 28, at 247.

48. See generally James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83 (1984); Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith and Structural Bias*, 32 J. CORP. L. 833 (2007); Donald C. Langevoort, *Ego, Human Behavior, and Law*, 81 VA. L. REV. 853 (1995); Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135 (2002); Donald C. Langevoort, *The Behavioral Economics of Mergers and Acquisitions*, 12 TRANSACTIONS: TENN. J. BUS. L. 65 (2011) [hereinafter Langevoort, *The Behavioral*]; Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635 (2003).

49. See James A. Fanto, *Quasi-Rationality in Action: A Study of Psychological Factors in Merger Decision-Making*, 62 OHIO ST. L.J. 1333, 1354–81 (2001); sources cited *supra* note 15; see also, e.g., Vicki Bogan & David Just, *What Drives Merger Decision Making Behavior? Don’t Seek, Don’t Find, and Don’t Change Your Mind*, 72 J. ECON. BEHAV. & ORG. 930, 932 (2009) (noting that confirmation bias, “a situation in which an individual attaches too much importance to information that supports his views,” impacts merger decisions); Deepak Malhotra, *The Desire to Win: The Effects of Competitive Arousal on Motivation and Behavior*, 111 ORG. BEHAV. & HUM. DECISION PROCESSES 139, 139 (2010) (examining “when and why potentially self-damaging competitive motivations and behaviors will emerge”); Deepak Malhotra et al., *When Winning Is Everything*, HARV. BUS. REV., May 2008, at 78, 80 (identifying “three principal drivers of competitive arousal in business settings: rivalry, time pressure, and audience scrutiny”).

and acquisition premiums, the greater the shareholder losses” following an acquisition.<sup>50</sup> Moreover, Hayward and Hambrick’s study also indicates that the relationship between acquisition premiums and CEO hubris is stronger in cases where the board has a high proportion of inside directors and a CEO who also serves as chair of the board.<sup>51</sup> Ulrike Malmendier and Geoffrey Tate’s study of the role of CEO overconfidence similarly suggests that overconfident CEOs tend to overpay.<sup>52</sup> The study finds “that the odds of making an acquisition are 65% higher if the CEO is classified as overconfident,” and that “[t]he effect is largest if the merger is diversifying and does not require external financing.”<sup>53</sup> The study suggests that the market reaction for merger announcements by an overconfident CEO is significantly more negative than for announcements by non-overconfident CEOs.<sup>54</sup>

Behavioral biases may be amplified by advisors, including investment bankers, consultants who have been hired to undertake significant integration efforts, and even lawyers advising acquirers.<sup>55</sup> Investment bankers, for example, are commonly conflicted in M&A transactions.<sup>56</sup> Bidders often use bankers to provide valuation assistance and fairness opinions in acquiring targets, but the vast bulk of an advisor’s compensation for this work depends on completion of the transaction.<sup>57</sup> In

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50. Mathew L. A. Hayward & Donald C. Hambrick, *Explaining the Premiums Paid for Large Acquisitions: Evidence of CEO Hubris*, 42 ADMIN. SCI. Q., 103, 103 (1997). Hayward and Hambrick identify four indicators of CEO hubris as relevant to the acquisition premium, “the acquiring company’s recent performance, recent media praise for the CEO, a measure of the CEO’s self-importance, and a composite factor of these three variables.” *Id.*; see also Arijit Chatterjee & Donald C. Hambrick, *It’s All About Me: Narcissistic Chief Executive Officers and Their Effects on Company Strategy and Performance*, 52 ADMIN. SCI. Q. 351, 351–52 (2007) (arguing that narcissistic CEOs favor strategic dynamism and grandiosity, and tend to deliver extreme and volatile performance for their organizations).

51. See Hayward & Hambrick, *supra* note 50, at 117–18.

52. See Malmendier & Tate, *supra* note 10, at 20; see also Ulrike Malmendier & Geoffrey Tate, *CEO Overconfidence and Corporate Investment*, 60 J. FIN. 2661, 2661 (2005) (“Overconfident managers overestimate the returns to their investment projects and view external funds as unduly costly.”).

53. Malmendier & Tate, *supra* note 10, at 20.

54. *Id.*

55. Krishnan and Masulis find that top bidder law firms are “associated with significantly higher takeover premia.” C. N. V. Krishnan & Ronald W. Masulis, *Law Firm Expertise and Merger and Acquisition Outcomes*, 56 J.L. & ECON. 189, 189 (2013).

56. See Andrew Ross Sorkin, *When a Bank Works Both Sides*, N.Y. TIMES (Apr. 8, 2007), <http://www.nytimes.com/2007/04/08/business/yourmoney/08deal.html>.

57. See Steven M. Davidoff, *Fairness Opinions*, 55 AM. U. L. REV. 1557, 1586–87 (2006).

cases where management stands to benefit from doing a deal, the often “close relationship” between company management and financial advisors can induce advisors to recommend transactions in order to “avoid displeasing management.”<sup>58</sup>

Anecdotal evidence suggests that despite CEO biases, often the board does not effectively stand in management’s way in large acquisitions. Once management and its advisors begin to feel committed to a deal and have expended significant resources to move forward on a transaction, abandoning plans can be quite difficult. For example, HP’s then-board chair allegedly attempted to raise concerns about the Autonomy acquisition, but then-CEO Leo Apotheker was reluctant to back away, and the board did not press any further.<sup>59</sup> The reluctance to abandon an acquisition can be strong even in the face of significant shareholder opposition. As discussed in Part II below, there are many ways in the U.S. for acquirers to avoid or take away the ability of bidder shareholders to express their opposition to an acquisition.<sup>60</sup>

## *II. The Rights of Bidder Shareholders in Acquisitions: Selling, Suing, and Voting*

Two structures—a one-step triangular merger, or a two-step transaction involving a tender offer followed by a merger—are often used to acquire publicly traded firms in the U.S.<sup>61</sup> Under both structures, target shareholders are commonly provided a say, either through a vote or through the decision to sell their shares. In addition, target shareholders can seek access to courts to address any harm they have suffered. U.S. law, however, does little to address harm to bidder shareholders. Transactions can be

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58. Tamar Frankel, *The Influence of Investment Banks on Corporate Governance*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 352, 357–58 (Claire A. Hill & Brett H. McDonnell eds., 2012); see also Davidoff, *supra* note 57, at 1587.

59. See Barb Darrow, *HP’s Ray Lane Tried to Kill Autonomy Deal, Documents Show*, FORTUNE (Sept. 26, 2015), <http://fortune.com/2015/09/26/hps-ray-lane-tried-to-kill-autonomy-deal/>.

60. See Stephen Bainbridge, *How and Why Kraft Is Evading Shareholder Voting in the Cadbury Deal*, PROFESSORBAINBRIDGE.COM (Jan. 21, 2010, 11:27 AM), <http://www.professorbainbridge.com/professorbainbridge.com/2010/01/evading-shareholder-voting-in-a-merger.html>; Steven Davidoff Solomon, *Warren Buffett’s Lost Vote*, N.Y. TIMES DEALBOOK (Jan. 21, 2010, 9:05 AM), <http://dealbook.nytimes.com/2010/01/21/warren-buffetts-lost-vote/>.

61. See John C. Coates, *Mergers, Acquisitions, and Restructuring: Types, Regulation, and Patterns of Practice* 4-5 (Harvard John M. Olin Discussion Paper Series, Paper No. 781, 2014), [http://www.law.harvard.edu/programs/olin\\_center/papers/pdf/Coates\\_781.pdf](http://www.law.harvard.edu/programs/olin_center/papers/pdf/Coates_781.pdf).

structured so that under state corporate law or stock exchange listing rules, bidder shareholders are excluded from any decision-making role in acquisitions.<sup>62</sup> Moreover, bidder shareholders cannot meaningfully seek any redress through the courts.

This section begins by recounting the limited voting rights that bidder shareholders have in acquisition transactions. It then provides a brief overview of why neither the shareholders' rights to sell or sue provide sufficient protection to bidder shareholders nor are useful checks on the factors that contribute to bidder overpayment.

#### *A. Bidder Shareholder Voting Rights*

Public company acquirers commonly use two types of transactional structures to purchase other public companies—triangular mergers and tender offers.<sup>63</sup> As explained below, under both structures, bidder shareholders are often deprived of voting rights.

##### *1. Triangular Mergers*

Over the past several decades, the triangular merger structure has emerged as one of the most popular acquisition structures. The triangular merger is a popular method for acquiring a firm for many reasons, including survivor liability issues because the bidder can acquire the target as a separate entity without having to incorporate it into the bidder corporation itself. Moreover, triangular acquisitions also have benefits related to preservation of the licenses and contracts of the target and potential tax benefits.<sup>64</sup>

One of the most important considerations for public companies, particularly for those incorporated in Delaware, is using the triangular structure to deprive bidder shareholders of voting and appraisal rights.<sup>65</sup>

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62. For a detailed discussion of this structuring, see generally Afra Afsharipour, *Deal Structure and Minority Shareholders*, in *COMPARATIVE TAKEOVER REGULATION: GLOBAL AND ASIAN PERSPECTIVES* (Umakanth Varottil & Wan Wai Yee, eds.) (forthcoming 2017) [hereinafter Afsharipour, *Deal Structure*].

63. See Coates, *supra* note 61, at 4–5.

64. See STEPHEN M. BAINBRIDGE, *MERGERS AND ACQUISITIONS* 56–57 (3d ed. 2012); THERESE H. MAYNARD, *MERGERS AND ACQUISITIONS: CASES, MATERIALS, AND PROBLEMS* 105–07 (3d ed. 2013).

65. Kimble C. Cannon and Patrick J. Tangney, *Protection of Minority Shareholder Rights Under Delaware Law: Reinforcing Shareholders as Residual Claimants and Maximizing Long-Term Share Value by Restricting Directorial Discretion*, 1995 COLUM. BUS. L. REV. 725, 762. The triangular merger also has several other benefits related to successor liability, tax and accounting issues.

Under Delaware General Corporation Law (“DGCL”) section 251(c), only shareholders of a “constituent” corporation are entitled to vote on the transaction, and under section 262(b)(2), appraisal rights are similarly available only to voting shareholders of a “constituent” corporation to the merger.<sup>66</sup> In a triangular structure, however, the actual bidder is not one of the “constituent” corporations; instead, it is the bidder’s shell subsidiary that merges with the target company.<sup>67</sup>

The ability of public company bidders to avoid a vote is somewhat limited in transactions where the acquisition structure involves the bidder’s stock. If the bidder needs to amend its charter to authorize the additional stock being issued in the transaction, bidder shareholders will in essence be voting on the acquisition since “shareholders will be voting on the amendment [with] full knowledge that the amendment is necessary to effect the deal as structured.”<sup>68</sup> Stock exchange rules may also require the bidders to solicit a vote of bidder shareholders if the bidder will be issuing stock amounting to more than 20% of its outstanding shares.<sup>69</sup> Bidders can,

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66. DEL. CODE ANN. tit. 8, §§ 251(c), 262(b)(2) (West 2016). Appraisal rights allow shareholders to refuse to accept the consideration offered in a deal and instead turn to the courts to determine the “fair value” of their shares. Until recently, appraisal was viewed as a limited remedy because of significant costs and delays connected with the exercise of appraisal rights, and the uncertainties of the valuation process. For an overview of the appraisal process and debates about its value, see Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1558–66 (2015). More recently, appraisal actions have gained some steam due to certain sophisticated investors, particularly hedge funds, acting as dissenting shareholders. See Korsmo & Myers, *supra*, at 1568. The rise in appraisal litigation has been rife with controversy and efforts to limit appraisal cases. See e.g. Craig Boyd, *Appraisal Arbitrage: Closing the Floodgates on Hedge Funds and Activist Shareholders*, 65 KAN. L. REV. 497, 522 (2016). Several scholars, however, cautioned against closing the door to appraisal, arguing that appraisal cases play an important corporate governance role and may have significantly more value than other types of shareholder litigation. See generally Charles Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829 (2014); Wei Jiang, Tao Li, Danqing Mei & Randall S. Thomas, *Appraisal: Shareholder Remedy or Litigation Arbitrage?*, 59 J. LAW & ECON. 697 (2016); Steven Davidoff Solomon, *Delaware Effort to Protect Shareholders May End Up Hurting Them*, N.Y. TIMES DEALBOOK (May 24, 2016), [https://www.nytimes.com/2016/05/25/business/dealbook/delaware-effort-to-protect-shareholders-may-end-up-hurting-them.html?\\_r=0](https://www.nytimes.com/2016/05/25/business/dealbook/delaware-effort-to-protect-shareholders-may-end-up-hurting-them.html?_r=0).

67. BAINBRIDGE, *supra* note 64, at 56.

68. Bainbridge, *supra* note 60.

69. See NASDAQ, NASDAQ STOCK MARKET RULES r. 5635(a)(1)(B) (amended 2009), <http://nasdaq.cchwallstreet.com/> (follow “Rule 5000” hyperlink; then follow “5600. Corporate Governance Requirements” hyperlink; then scroll down to Rule 5635); NYSE,

however, structure their transactions to include a combination of cash and stock where the stock component constitutes no more than 19.9% of issued and outstanding bidder shares.<sup>70</sup>

But even if bidder shareholders do get a vote based on charter amendment or stock exchange rules, they would not receive appraisal rights under state corporate law.

## 2. Tender Offers

Tender offers are the other common acquisition structure used by public company acquirers.

The Williams Act, which is codified in sections 13(d) and 14(d)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”), regulates tender offers.<sup>71</sup> Much of the focus of the Williams Act is on protecting the target company shareholders.<sup>72</sup> While shareholders of the target have layers of protection encompassed within the Exchange Act rules in tender offer transactions, bidder shareholders in general have little protection under federal or state corporate law. The Williams Act does not squarely address the rights of bidder shareholders.

Similarly, state corporate law often excludes a role for bidder shareholders in tender offers. Delaware law does not include a statutory requirement for bidder shareholders to have a vote in a tender offer transaction.<sup>73</sup> Thus, unless the acquirer does not have enough authorized

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LISTED COMPANY MANUAL § 312.03(c)–(d) (amended 2015), <http://nysemanual.nyse.com/lcm/> (follow “Section 303A.00” hyperlink). The voting requirements under both the NYSE and NASDAQ rules do not require a vote of a majority of the outstanding shares. *See* NASDAQ STOCK MARKET RULES r. 5635(e) (requiring a majority of votes cast on a particular proposal); *id.* r. 5620(c) (requiring at least one-third of all voting shares to be present for purposes of a quorum); NYSE, LISTED COMPANY MANUAL § 312.07 (amended 2013) (requiring a majority of the voting shares for approval, so long as over 50% of the voting shares participate in the vote).

70. *See* Afsharipour, *Shareholders’ Put Option*, *supra* note 26, at 1046–47.

71. For an overview of the history of the Williams Act, see generally Christina M. Sautter, *Tender Offers and Disclosure: The History and Future of the Williams Act*, in RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 352 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

72. *See* Afsharipour, *Deal Structure*, *supra* note 62, at 9.

73. *See* Joel Edan Friedlander, *Overturn Time-Warner Three Different Ways*, 33 DEL. J. CORP. L. 631, 641–43 (2008). Some jurisdictions, most notably California, provide bidder shareholders a vote in tender offers where the consideration consists of the stock of the acquirer’s shareholders. *See* CAL. CORP. CODE § 1201.5 (West 1990). Like the voting rules in other types of acquisition transactions, the exception under section 1201.5(b) of the California Corporations Code provides that approval is not needed by the shareholders of an



and unissued shares in a stock-for-stock tender offer, bidder shareholders have no voting rights under state corporate law.<sup>74</sup> Moreover, if the bidder is using cash or less than 20% of its outstanding stock as the acquisition currency, then the stock exchange rules necessitating a shareholder vote would not apply.

### *B. Shareholders' Rights to Sell or Sue*

Shareholder rights are not limited to voting rights. Shareholders unhappy with corporate decisions may also sell their shares—in other words, exercise their “wall street vote,” or attempt to bring litigation against the board, in particular through fiduciary duty litigation. Yet, both the right to sell and the right to sue have failed to temper bidder overpayment and its underlying causes.

#### *1. Why the Right to Sell May Not Sufficiently Counter Bidder Overpayment*

One of the key rights held by shareholders, particularly public company shareholders, is the right to sell shares at will.<sup>75</sup> Scholars have long hailed the right to sell shares as particularly strong and important to shareholders “because it is a means of obtaining economic benefit from their investment in the corporation and because it is their means of exit should they become dissatisfied with management.”<sup>76</sup> The right to sell has been described as “robust”<sup>77</sup> and as a primary mechanism to address agency problems in companies.<sup>78</sup> Henry Manne famously argued that a decrease in share price as a result of discontented shareholders selling their shares would provide

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entity which will own more than 83.3% (or five-sixths) of the voting power of the surviving corporation immediately after the transaction. *See id.* § 1201.5(b).

74. *See* Friedlander, *supra* note 73, at 641–43.

75. *See* Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: “Sacred Space” in Corporate Takeovers*, 80 TEX. L. REV. 261, 304 (2001). There are some restrictions on the right to sell shares, such as federal securities laws with respect to insider trading and limitations imposed via contract. *See generally* Julian Velasco, *The Fundamental Rights of Shareholders*, 40 U.C. DAVIS L. REV. 407, 415–16 (2006).

76. Velasco, *supra* note 75, at 425.

77. *Id.*

78. *See, e.g.,* Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 273 (1967). For an overview of the literature on the right to sell, see generally James J. Park, *The Limits of the Right to Sell and the Rise of Federal Corporate Law*, 70 OKLA. L. REV. 159 (2017).

an opportunity to third parties to replace inefficient management.<sup>79</sup> According to Manne, “[t]he lower the stock price, relative to what it could be with more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently.”<sup>80</sup>

The right to sell, however, is not without limitation. In the context of bidder overpayment, it is not clear that post-announcement sale of shares has to date disciplined public company managers in their acquisition decisions. Bidder shareholders do not usually have information about an upcoming acquisition until the acquisition is announced, typically immediately after the parties sign the acquisition agreement. The response of shareholders to many large public company acquisitions has been to sell their shares, resulting in the phenomenon that bidder share prices often react negatively upon announcement of an acquisition of a public company.<sup>81</sup> Nevertheless, once an acquisition agreement has been signed, even if bidder shareholders react negatively to the announced deal, the opportunity for the bidder to walk away is low.<sup>82</sup> In the case of a bad acquisition decision, then, bidder shareholders are rarely able to protect themselves from significant losses. Moreover, since bidder shareholders often do not have voting rights in acquisition decisions, bidder management is not particularly incentivized to gauge shareholder reaction to an acquisition prior to an announcement.

In addition, the destruction of long-term value of the acquiring firm, as demonstrated by firms such as HP, often arises long after managers have left the firm. Even if the managers stick around, “[s]elling shares effectively disciplines management only if the market for corporate control is robust.”<sup>83</sup> The market for corporate control, however, has been substantially

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79. See Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965).

80. *Id.* at 113.

81. See Kathleen Fuller et al., *What Do Returns to Acquiring Firms Tell Us? Evidence from Firms That Make Many Acquisitions*, 57 J. FIN. 1763, 1764 (2002).

82. See Afra Afsharipour, *Transforming the Allocation of Deal Risk Through Reverse Termination Fees*, 63 VAND. L. REV. 1161, 1173–78 (2010). The ability of a buyer to walk away from a transaction prior to closing is often subject to a material adverse change (MAC) or material adverse effect in the seller’s business. Convincing a court that a MAC has occurred in the seller’s business has proved to be difficult for buyers. MAYNARD, *supra* note 64, at 383–86.

83. Edelman et al., *supra* note 16, at 1366.

eroded by directors' ability to adopt significant defensive tactics, such as poison pills.<sup>84</sup>

## 2. Shortcomings in Fiduciary Duty Litigation

In addition to the right to sell, shareholders also hold the right to sue. In acquisition transactions, particularly large public company deals, both the boards of the bidder and target generally consider and vote on the transaction. The boards' involvement in these transactions, which for targets is often statutorily mandated, can then expose the boards to potential fiduciary duty claims from shareholders. The claims raised by shareholders in fiduciary duty cases often involve issues surrounding the business judgment rule, the duty of care, and the duty of loyalty (including good faith).<sup>85</sup>

Corporate law casebooks are replete with cases where shareholders of the target company have brought fiduciary duty claims against the target's board. The Delaware courts' case law on the fiduciary duties of target boards is a mainstay of U.S. corporate law debates.<sup>86</sup> Fiduciary duty litigation against target boards is often expected in large public company acquisition transactions.<sup>87</sup>

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84. See generally Christine Hurt, *The Hostile Poison Pill*, 50 U.C. DAVIS L. REV. 137 (2016).

85. See Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 167 (2004). The Delaware courts have opined that failure to act in good faith is in essence a failure of the duty of loyalty. In other words, failing to act in good faith means that a Board has intentionally failed "to act in the face of a known duty to act, demonstrating a conscious disregard for his duties." *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2009) (quoting *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006)).

86. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986) (holding that in the event of a change or control or break-up of the company, enhanced scrutiny applied); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) ("Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711–15 (Del. 1983) (holding that in freeze-out mergers the requirements of entire fairness, including fair dealing and fair price, applied). See generally J. Travis Laster, *Revlon Is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 9–11, 53–54 (2013) (examining the *Revlon* standard and its progeny).

87. See Thompson & Thomas, *supra* note 85, at 135, 137 (documenting the rise of merger litigation between 1999 and 2000). The last decade witnessed a staggering increase in merger litigation, as evidenced by Cain and Davidoff Solomon's comprehensive study of 1117 transactions from 2005 through 2011. See Matthew D. Caine & Stephen Davidoff

Unlike the vast number of fiduciary duty cases against target boards, fiduciary duty cases against bidder boards are rarely brought and even more rarely successfully litigated.<sup>88</sup> Theoretically, bidder boards' decision-making role in major acquisitions could make the boards vulnerable to shareholder lawsuits. This theoretical possibility, however, is unlikely to come to fruition. The study by Robert B. Thompson and Randall S. Thomas, for example, shows that most fiduciary duty suits challenge director actions in the sale of a company, rather than director actions with respect to the decision to acquire a company.<sup>89</sup> Despite the vast increase in M&A litigation, plaintiff lawyers do not often endeavor to bring fiduciary duty suits against bidder boards given that the value of such suits is rather low. Moreover, in the few cases that have been brought against bidder boards, shareholders have not been successful.<sup>90</sup>

The norm of deference to board decision-making plays a powerful role in curtailing suits against bidder boards. No established body of case law examines fiduciary duties of bidder boards.<sup>91</sup> In general, courts' usual response to a shareholder complaint<sup>92</sup> in an acquisition negotiated on an arm's-length basis is to apply the highly deferential business judgment standard of review to the allegations of the complaint.<sup>93</sup> If the board's decision to acquire the target is merely careless or negligent, such a

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Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 475–77 (2015). The rise in merger litigation was substantially curtailed in 2015 due in large part to the Delaware Court of Chancery's refusal to approve immaterial disclosure-only settlements. See Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2015 3* (Jan. 14, 2016) (unpublished report), <https://ssrn.com/abstract=2715890>.

88. See Afsharipour, *Shareholders' Put Option*, *supra* note 26, at 1055–60.

89. See Thompson & Thomas, *supra* note 85, at 167.

90. See, e.g., *In re Dow Chem. Co. Derivative Litig.*, No. 4349-CC, 2010 WL 66769 (Del. Ch. Jan. 11, 2010); *Ash v. McCall*, No. 17132, 2000 WL 1370341 (Del. Ch. Sept. 15, 2000).

91. See Lawrence. A. Hamermesh, *Premiums in Stock-For-Stock Mergers and Some Consequences in the Law of Director Fiduciary Duties*, 152 U. PA. L. REV. 881, 909 (2003).

92. Shareholders can bring fiduciary duty claims directly if they, rather than the corporation, suffered the injury. Such direct claims tend to be limited to claims brought by shareholders of target companies. See Thompson & Thomas, *supra* note 85, at 167–68.

93. The business judgment rule is “a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts.” *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

decision does not amount to a duty of care violation.<sup>94</sup> To be clear, in these duty of care cases, shareholders' only option is to attack the board's decision-making process rather than the actual business result.<sup>95</sup> Even if the board violates its duty of care—that is, the board is grossly negligent in the process it undertook to approve the deal—a damages claim against directors for violations of the duty of care is unavailable because most companies' charters include a statutory exculpation provision limiting such claims.<sup>96</sup>

Duty of loyalty litigation is also not generally fruitful in arms-length acquisitions. The types of agency costs identified in the bidder overpayment literature tend to be soft conflicts that are hard to address through litigation and the courts.<sup>97</sup> These soft conflicts differ from the classic duty of loyalty cases—often involving controlling shareholders or management buyouts—that arise in merger-related litigation.<sup>98</sup> Moreover, alleging bad faith by bidder shareholder plaintiffs is even more difficult, as the courts have stated that bad faith, in a transactional context, requires an “extreme set of facts . . . premised on the notion that disinterested directors were intentionally disregarding their duties.”<sup>99</sup>

Despite these litigation challenges, some scholars have previously advocated for greater judicial responses to the bidder overpayment problem.<sup>100</sup> Others, concerned with the high costs of litigation, have warned

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94. See *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985) (articulating that the standard for determining a breach of the duty of care is gross negligence), *overruled in part on other grounds* by *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

95. See E. Norman Veasey, *Law and Fact in Judicial Review of Corporate Transactions*, 10 U. MIAMI BUS. L. REV. 1, 11 (2002).

96. See DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2016).

97. Commentators often refer to the concept of soft conflicts, for example situations where management may not be on both sides of a transaction in a way that clearly implicates the duty of loyalty, but where management may for self-interested reasons steer a transaction in a certain direction. See, e.g., Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-making and Reduce the Litigation Target Zone*, 70 BUS. LAW. 679 (2015).

98. See Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1786 (2004) (finding that after Delaware adopted section 102(b)(7) allowing companies to opt out of liability for the duty of care, the bulk of derivative suits brought in Delaware were duty of loyalty claims involving conflicted director actions).

99. *In re Dow Chem. Derivative Litig.*, No. 4349-CC, 2010 WL 66769, at \*10 (Del. Ch. Jan. 11, 2010) (quoting *Lyondell Chem. Corp. v. Ryan*, 970 A.2d 235, 243 (Del. 2009)).

100. See, e.g., George W. Dent, Jr., *Unprofitable Mergers: Toward a Market-Based Legal Response*, 80 NW. U. L. REV. 777, 784 (1986); James A. Fanto, *Braking the Merger Momentum: Reforming Corporate Law Governing Mega-Mergers*, 49 BUFF. L. REV. 249, 341–44 (2001); Hamermesh, *supra* note 91, at 900–11.

against litigation as a tool to address bidder overpayment.<sup>101</sup> Given the dearth of buy-side shareholder litigation, it is unclear whether greater judicial scrutiny of board decisions could address the agency costs or behavioral biases contributing to bidder overpayment.

### *III. Reassessing Shareholder Voting in Acquisitions*

Is it time to reexamine voting given the existing, relatively low voting incidences and shortcomings with selling and suing?

Several prominent legal scholars have suggested shareholder voting rights for bidder shareholders, but much of this debate has been muted over the past ten years. In response to the contemporary empire-building literature of the 1980s, Professor Coffee suggested the adoption of a rule that would require a tender offer acquirer to obtain approval from the acquirer's own shareholders.<sup>102</sup> Professor Coffee explained that requiring acquirer shareholder approval would discourage inefficient empire-building and acquirer overpayment, while preserving the market for corporate control.<sup>103</sup> Similarly, in his article explaining the overpayment hypothesis, Professor Black agreed that Professor Coffee's suggestion was an option worth exploring.<sup>104</sup> In particular, scholars have argued for shareholder voting rights for bidder shareholders in certain acquisitions, such as transactions over a certain size.<sup>105</sup>

Whether shareholder voting can be a tool to address bidder overpayment is an important empirical question to which finance studies have turned several times. Section A below addresses the empirical research on voting and bidder overpayment, including recent literature that strongly suggests that mandatory voting imposes constraints on acquirer CEOs and can serve as a deterrent to large value-destroying acquisitions. Section B then discusses the arguments for shareholder voting in public company acquisitions. Section C examines the ways to achieve voting rights. Section C then addresses arguments against shareholder voting.

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101. See Black, *supra* note 14, at 651. For a discussion of litigation agency costs, see Afsharipour, *Shareholders' Put Option*, *supra* note 26, at 1070-71.

102. See Coffee, *Regulating*, *supra* note 14, at 1269-72. While Professor Dent raised several objections to the shareholder voting proposal put forth by Professor Coffee, he acknowledged that it would be an improvement to the lack of protection under corporate law for bidder shareholders. See Dent, *supra* note 100, at 786-94.

103. See Coffee, *Regulating*, *supra* note 14, at 1269.

104. See Black, *supra* note 14, at 652.

105. See, e.g., Coffee, *Regulating*, *supra* note 14, at 1281-82; Hamermesh, *supra* note 91, at 911.

*A. Empirical Studies of the Effects of Bidder Shareholder Voting*

Studies have empirically assessed the effects of shareholder voting in addressing bidder overpayment and the root causes of overpayment. Several recent papers provide important insights on whether mandatory shareholder voting can prevent bidder overpayment.

Most of the research on voting by bidder shareholders in acquisitions has been conducted on U.S. transactions. Undertaking empirical assessments of U.S. acquisitions, however, is challenging for multiple reasons. Under U.S. corporate law rules and listing standards, voting on acquisitions is up to the bidder's management, and the management can choose to structure its acquisition to avoid a vote by bidder shareholders. Management can even amend the voting rights of bidder shareholders after the announcement of a deal if it appears that shareholders might oppose the transaction.<sup>106</sup>

One of the earliest studies of bidder shareholder approval by Timothy R. Burch et al. finds that merger proxy votes may provide some monitoring of management even though approval rates for votes on acquisitions are higher than other types of shareholder votes.<sup>107</sup> Another early study by Jim Hsieh and Qinghai Wang suggests that shareholder voting rights could discourage opportunistic behavior by bidder management. Hsieh and Wang find that "acquisitions without acquirer shareholder approval are associated with lower synergistic gains, both in percentage and dollar values."<sup>108</sup> Their study also presented evidence that "deals without shareholder voting rights are associated with worse post-merger stock or operating performance than those with voting rights. This indicates that the requirements of shareholder voting help deter management from pursuing mergers that are not favored by shareholders."<sup>109</sup> Other working papers, however, do not find much evidence of the value of bidder shareholder voting.<sup>110</sup>

Recently, two working papers on the value of bidder shareholder voting reached differing results from each other. Paul Mason, Mike Stegemoller and Steven Utke examine the initial implementation of NASDAQ's 1989

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106. See sources cited *supra* note 60.

107. See Timothy R. Burch et al., *Is Acquiring-Firm Shareholder Approval in Stock-for-Stock Mergers Perfunctory?*, FIN. MGMT., Winter 2004, at 45, 51.

108. Jim Hsieh & Qinghai Wang, *Shareholder Voting Rights in Mergers and Acquisitions 5* (Mar. 2008) (unpublished manuscript), [http://www1.american.edu/academic.depts/ksb/finance\\_realestate/rhauswald/seminar/vote\\_American.pdf](http://www1.american.edu/academic.depts/ksb/finance_realestate/rhauswald/seminar/vote_American.pdf).

109. *Id.*

110. See, e.g., Ehud Kamar, *Does Shareholder Voting on Acquisitions Matter?* 2, 4-5 (Am. Law & Econ. Ass'n Annual Meetings, Working Paper No. 64, 2006), <http://law.bepress.com/cgi/viewcontent.cgi?article=1799&context=alea>.

adoption of the rule requiring a shareholder vote when the bidder issues 20% or more of its stock.<sup>111</sup> Mason et al. find that firms altered the structure of their transactions to avoid a shareholder vote, often by using seasoned equity offerings prior to an acquisition announcement.<sup>112</sup> Nevertheless, when examining the performance of acquisitions following the enactment of the NASDAQ 20% rule, Mason et al. find little evidence that shareholder voting provides benefits to bidder shareholders.<sup>113</sup>

Unlike the Mason et al. study, a study of more recent transactions by Kai Li, Tingting Liu and J. Wu finds value in bidder shareholder voting. Li et al. investigate the effects of bidder shareholder voting by comparing deals subject to a vote with those not subject to a vote in a hand-collected sample of U.S. stock deals over the period 1995-2015.<sup>114</sup> Li et al. find that bidder management substitutes stock with cash “to avoid triggering the 20% rule and hence shareholder voting; and that this maneuver is less likely to take place when acquirer institutional ownership is high.”<sup>115</sup> The study also shows that in deals where the vote of bidder shareholders was avoided, acquirer announcement returns were 3% lower than those requiring shareholder voting.<sup>116</sup> They point out that “[g]iven that the average acquirer has a market capitalization of \$3.2 billion in the sample, a 3.0% difference in stock returns around the merger announcement corresponds to a value

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111. See Paul Mason et al., *The Effect of Shareholder Voting Requirements on Method of Payment and Performance Outcomes in Acquisitions* (Jan. 2, 2017) (unpublished manuscript), <https://ssrn.com/abstract=2844943>.

112. See *id.* at 6.

113. See *id.* at 4, 6. One challenge with the study by Mason et al. is that the transactions that it studies happened almost twenty years ago. Much of this period is prior to significant development of acquisition-focused case law in the Delaware courts which focuses on potential conflicts in the sale of a company and thus provides incentives for target boards to advocate more aggressively for a higher price in sale transactions. See *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242 (Del. 2009) (“There is only one *Revlon* duty—to “[get] the best price for the stockholders at the sale of the company.”); *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 (Del. 1993) (stating that a negotiated acquisition is one of those “rare situations which mandate that a court take a more direct and active role in overseeing the decisions made and actions taken by directors”); *id.* at 44 (“In the sale of control context, the directors must focus on one primary objective—to secure the transaction offering the best value reasonably available for the stockholders—and they must exercise their fiduciary duties to further that end.”); *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 439 (Del. Ch. 2012); *In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573, 597 (Del. Ch. 2010).

114. See Kai Li et al., *Vote Avoidance and Shareholder Voting in Mergers and Acquisitions* 1-2 (European Corp. Governance Inst. Working Paper Series in Fin., Paper No. 481/2016), <https://ssrn.com/abstract=2801580>.

115. *Id.* at 2.

116. *Id.*



reduction of over \$96 million, an economically significant amount to acquirer shareholders.”<sup>117</sup> The Li et al. study also finds “a large and significant jump in acquirer announcement returns at the 20% threshold in all-stock deals when shareholder voting is mandatory,” and this effect is concentrated among acquirers with more effective shareholder monitoring as proxied by high institutional ownership.<sup>118</sup> They argue that “shareholder voting adds value because it commits acquirer management to make deals with greater synergies and strengthens its bargaining position against target management, which prevents overpayment.”<sup>119</sup>

Other studies of U.S. transactions indicate that institutional shareholders value voting rights. For example, Gregor Matvos and Michael Ostrosky examine the holdings of institutional investors and their returns around merger announcements and find that although the votes are still overwhelmingly in favor of the merger, shareholders solely invested in the acquirer are generally four times more likely to vote against a merger as a cross-owner.<sup>120</sup> Moreover, studies suggest that, on average, institutional shareholders value both voting and cash-flow rights. A study by Jennifer E. Bethel et al. finds that institutional buying before the record dates set for voting rights increases voting turnout but negatively relates to shareholder support of the merger.<sup>121</sup>

In addition to institutional investors, voting rights may also invite activity from activist shareholders. In a working paper by Wei Jiang, Tao Li and Danqing Mei, the authors study forty-seven deals between 2000 and 2014 where bidder shareholders had voting rights.<sup>122</sup> According to the study, activists targeted stock deals that on average were much larger in size, so-called mega-deals, and deals that involved multiple bidders at announcement.<sup>123</sup> In these transactions, activist shareholders were able to lower the premium paid to the target company and even block the

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117. *Id.*

118. *Id.* at 26.

119. *Id.*

120. See Gregor Matvos & Michael Ostrovsky, *Cross-Ownership, Returns, and Voting in Mergers*, 89 J. FIN. ECON. 391, 399 (2008).

121. See Jennifer E. Bethel et al., *The Market for Shareholder Voting Rights Around Mergers and Acquisitions: Evidence from Institutional Daily Trading and Voting*, 15 J. CORP. FIN. 129, 131 (2009).

122. See Wei Jiang et al., *Influencing Control: Jawboning in Risk Arbitrage* 6, 9-10 (Columbia Bus. Sch. Research Paper No. 15-41, 2016), <https://ssrn.com/abstract=2587925>.

123. For an explanation of bidder shareholder rights in large stock deals, see *supra* notes 68-69 and accompanying text.

acquisition altogether.<sup>124</sup> The authors posit that “[t]o the extent that a large number of acquisitions of public targets seem to be value destructive for acquirer shareholders, especially when compounded with weak governance . . . , activist arbitrageurs on the acquirer side constitute a powerful counterbalance.”<sup>125</sup>

An important recently published study on the value of bidder shareholder voting rights was conducted by Becht, Polo and Rossi, focusing on acquisition transactions in the U.K.<sup>126</sup> Unlike the United States, where there is little bidder shareholder involvement in acquisition transactions, for large acquisitions in the U.K., shareholder voting is both mandatory and binding.<sup>127</sup> For shareholders of listed companies, Listing Rule 10 of the United Kingdom Financial Conduct Authority requires prior approval from shareholders of the acquirer in transactions that are large relative to the acquirer (Class 1 transactions).<sup>128</sup> The U.K. listing rules use several tests to measure relative size to determine a Class 1 transaction.<sup>129</sup> “Each test employs a different measure of relative size.”<sup>130</sup> A deal that equals or exceeds the 25% threshold in any one of these tests must obtain a vote from shareholders of the acquirer, while any transaction under this 25% threshold will not require shareholder voting.<sup>131</sup> Reviewing a large sample of U.K. transactions over an eighteen-year period, Becht et al. find that the U.K.’s mandatory voting requirement positively impacts bidder shareholders.<sup>132</sup> More specifically, the study finds that shareholders gain eight cents per dollar at the announcement of a Class 1 deal, or \$13.6 billion over 1992-2010 in aggregate.<sup>133</sup> In the U.K., relatively smaller Class 2 transactions do not require a vote, and shareholders lost \$3 billion.<sup>134</sup> Becht et al. argue that

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124. See Jiang et al., *supra* note 122 at 6, 32.

125. *Id.* at 6.

126. See Becht et al., *supra* note 23, at 3037.

127. See *id.*

128. See FINANCIAL CONDUCT AUTHORITY HANDBOOK, at Listing Rule 10 (2017) (U.K.), <https://www.handbook.fca.org.uk/handbook/LR/10.pdf> [hereinafter FCA HANDBOOK].

129. See *id.* at Listing Rule 10.2.1, 10 Annex 1; Becht et al., *supra* note 23, at 3041–42. A class 1 transaction refers to a transaction that amounts to 25% or more of any of the acquirer’s gross assets, profits, or gross capital, or in which the consideration is 25% or more of the market capitalization of the acquirer’s common stock. FCA HANDBOOK, *supra* note 128, at Listing Rule 10.2.2, 10 Annex 1.

130. Becht et al., *supra* note 23, at 3037.

131. See FCA HANDBOOK, *supra* note 128, at Listing Rule 10.2.2; Becht et al., *supra* note 23, at 3037.

132. See Becht et al., *supra* note 23, at 3035, 3039.

133. *Id.* at 3035, 3050.

134. See *id.*

mandatory voting makes bidder management more likely to refrain from overpaying or proposing deals that are not in the interest of shareholders.<sup>135</sup>

Interestingly, Becht et al. find that the mandatory voting mechanism works as a credible threat against bad corporate acquisitions because shareholders never voted against Class 1 transactions ex-post, and deals that were poorly received by the market at announcement were often withdrawn prior to the shareholder vote.<sup>136</sup> Together with the study of U.S. transactions by Li et al., the study by Becht et al. provides important empirical support for greater consideration of shareholder voting rights by bidder shareholders.

### *B. Why Voting Rights for Bidder Shareholders?*

Voting by shareholders “has come roaring back as a key part of American corporate governance.”<sup>137</sup> Several important developments have led to the rise of shareholder voting: (1) government regulations that “require many institutions to vote their stock in the best interests of their beneficiaries”; (2) the emergence and increasing importance of proxy advisory firms, “which help address the costs of voting and the collective action problems inherent in coordinated institutional shareholder action”; and (3) the increasingly important corporate governance role played by activist investors, such as hedge funds, which has led to greater use of the ballot box and the accompanying result of greater institutional shareholder engagement with voting rights.<sup>138</sup>

Edelman et al. set forth important theoretical support for shareholder voting rights, arguing that “shareholder voting should lead to value-maximizing decisions for the firm as a whole,”<sup>139</sup> an insight that is supported by the recent empirical research discussed in Section A above. They acknowledge that shareholders should not vote on routine decisions by management or the board of directors.<sup>140</sup> Rather, they argue that a vote by shareholders can serve a “monitoring role if the issue being decided affects the company’s stock price, or long-term value, and if the shareholder vote is likely to be superior, or complementary, to monitoring by the board or the market.”<sup>141</sup> As they note, the supplemental monitoring role is

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135. *See id.* at 3061–62.

136. *See id.* at 3063–64.

137. Edelman et al., *supra* note 16, at 1359.

138. *Id.* at 1361.

139. *See id.* at 3063–64.

140. *See id.* at 1363, 1367.

141. *Id.* at 1363.

especially significant when “officers or directors of the company suffer from a conflict of interest, or may otherwise be seeking private benefits at the expense of the firm.”<sup>142</sup> These soft conflicts, agency problems, and biases are the exact types of situations that research indicates are implicated in significant acquisition decisions by public companies.<sup>143</sup>

Two arguments against bidder shareholder voting rights in acquisition transactions relate to the cost of the vote as well as to concerns about the value of shareholder decisions. Voting is costly and uncertain, especially in a significant transaction, and could potentially lead to additional deal risk.<sup>144</sup> Voting rights may also not result in shareholders making an informed decision, especially if shareholders are apathetic and/or suffer from collective action problems.<sup>145</sup>

The above arguments against shareholder voting are tempered by the rise of institutional investors.<sup>146</sup> Institutional investors have significant voting power since they own a majority of the shares of publicly traded companies.<sup>147</sup> The significant change in ownership of U.S. public companies, resulting in a greater concentration of ownership in the hands of institutional shareholders,<sup>148</sup> makes voting by bidder shareholders in large public company transactions much more palatable. The “[i]ncreased concentration of shareholding makes shareholder activism more rational, making it easier for shareholders to surmount the classic collective action problem that forms the basis for much of corp

orate law, namely, the problem facing dispersed shareholders in disciplining management.”<sup>149</sup> Their large ownership stake coupled with the increasing influence of other market participants, such as hedge funds and

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142. *Id.*

143. *See id.* at 1363, 1378.

144. *See* Langevoort, *The Behavioral*, *supra* note 48, at 75.

145. *See id.* at 69, 75-76.

146. *See* Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1741 (2008) (“[H]edge funds may attempt to play an activist role in a pending merger or acquisition generally by asking for a better price . . . or by trying to stop the pending acquisition.”).

147. *See* Fisch, *Standing Voting Instructions*, *supra* note 20, at 10.

148. *See* Edelman et al., *supra* note 16, at 1386-88. *See generally* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 COLUM L. REV. 863 (2013).

149. Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 452 (1991); *see also* Fisch, *Standing Voting Instructions*, *supra* note 20, at 11-12 (recounting various regulatory developments which led to greater institutional investor attention to exercising their voting rights).

proxy advisory firms, may mean that institutional investors have strong economic and political interests in monitoring management's decisions via voting.<sup>150</sup> Moreover, voting rights may invite interference from activists that focus on deals that may be risky or more prone to overpayment.<sup>151</sup>

Even the threat of monitoring by institutional shareholders may be enough to address the bidder overpayment problem and its underlying causes. One argument against voting rights for bidder shareholders has been the significant transaction costs and deal uncertainty involved in providing the right.<sup>152</sup> Becht et al., however, found that voting served as a deterrent to and constraint on overpayment, and in their sample, shareholders never voted against Class 1 transactions following announcement of the deal.<sup>153</sup> In essence, "the mere prospect of the vote," rather than the actual vote itself, plays an important role in management calculations about the acquisition.<sup>154</sup> Becht et al. also found "little evidence that the deal flow is affected by shareholder approval."<sup>155</sup>

Shareholder voting rights also implicate director primacy.<sup>156</sup> Several scholars contend that deference to board decisions is both optimal and desirable.<sup>157</sup> Stephen M. Bainbridge argues, for example, that "[i]n general shareholders of public corporations have neither the legal right, the practical ability, nor the desire to exercise the kind of control necessary for meaningful monitoring of the corporation's agents."<sup>158</sup> But while board primacy may have some academic appeal, the argument is overstated.<sup>159</sup> Directors are not often the initiators or the driving force behind decisions to acquire another company; instead their primary role in acquisitions is to

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150. See Edelman et al., *supra* note 16, at 1401, 1418; Fisch, *Standing Voting Instructions*, *supra* note 20, at 12-13.

151. See *supra* notes 122-125 and accompanying text.

152. Langevoort, *The Behavioral*, *supra* note 48, at 75.

153. See Becht et al., *supra* note 23, at 3061, 3063-64.

154. *Id.* at 3050.

155. *Id.* at 3064.

156. Professor Bainbridge has long advocated for the value of the primacy of the board, including in acquisition decisions. See Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1746-51 (2006); see also Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 251-55 (1999).

157. See generally Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003).

158. *Id.* at 568.

159. See generally Robert B. Thompson, *Anti-Primacy: Sharing Power in American Corporations*, 71 BUS. LAW. 381 (2016) (arguing that corporate governance is best understood as a shared power among shareholders, directors and officers).

monitor management who are “the key decision makers in corporate decisions, a point that reflects the influence of market and economic realities more than a command from law.”<sup>160</sup> Moreover, with respect to acquisition decisions, board primacy arguments fail to consider the vast empirical literature that suggests that boards, when confronted by management’s soft conflicts and behavioral biases in significant acquisition decisions, need the assistance of an additional monitor or check.

So why have shareholders not advocated for voting rights in large acquisition transactions? Several reasons come to mind. First, large public company acquisitions often occur when companies are doing well and not when they are the target of shareholder advocates. Second, institutional shareholders have not always been strong governance advocates as a whole, especially without some pressure from more activist investors.<sup>161</sup> And activist investors have little incentive to get involved in acquisition transactions if they do not have rights that can provide them with an ability to hold up the transaction.<sup>162</sup> Moreover, acquisition activity tends to come in waves, and by the time the significance of overpayment by bidders becomes readily apparent, acquisitions may be on a downward trend, making the issue appear less salient to shareholder activists.

In sum, the argument for shareholder voice in significant public company acquisition decisions is not an argument for shareholder voting rights in all transactions, but rather an argument for shareholder voice in situations of high importance to firm value and share price, and where empirical inquiry seems to consistently demonstrate shortcomings in the board’s monitoring role.<sup>163</sup>

### *C. Achieving Voting Rights for Bidder Shareholders*

There are several ways to achieve voting rights for bidder shareholders in significant transactions. Although it is beyond the scope of this article to detail in full the costs, benefits, and feasibility of each of these ways, this section explores some of the general methods by which voting rights could be provided to bidder shareholders in significant acquisitions.

One way to provide bidder shareholders with voting rights in large public company acquisitions is through amendment of stock exchange rules, akin to the listing rules adopted in the United Kingdom. Such an

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160. *Id.* at 404.

161. *See generally* Gilson & Gordon, *supra* note 148.

162. For an example of activist bidder shareholder activity, see Jiang et al., *supra* note 122, at 58–59.

163. *See* Edelman et al., *supra* note 16, at 1374–75.

amendment would necessarily require significant advocacy by organized institutional investors. Advocacy of voting rights for bidder shareholders by institutional investors is not out of the realm of possibility. As scholars have observed, “the provision of finance through institutional investors . . . will produce investor groups that are better organized and more sophisticated in their inputs into the lawmaking process.”<sup>164</sup> Shareholder voting has become increasingly important and more common over the past decade.<sup>165</sup> Any amendment in listing rules to provide bidder shareholders with voting rights will likely be vociferously opposed by corporate managers and their advocates who have expressed deep reservations about greater shareholder power and say.<sup>166</sup> Nevertheless, the greater voices of activists and institutional investors in public debates about corporate governance could be an important lever to pressure the U.S. stock exchanges to at least consider a debate over a voting rule for significant transactions in line with the U.K. listing rules.<sup>167</sup>

Private ordering could be another solution for providing voting rights to bidder shareholders. Shareholders could advocate for either advisory votes or binding votes (through a charter or bylaw amendment) on significant public company acquisitions.<sup>168</sup> Corporate charters and bylaws are often viewed as intra-corporate contracts.<sup>169</sup> It is possible that shareholders could

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164. John Armour et al., *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*, 52 HARV. INT'L L.J. 219, 225 (2011).

165. See Gilson & Gordon, *supra* note 148, at 897; see also Fisch, *Standing Voting Instructions*, *supra* note 20, at 4 (explaining the increasing range of issues on which shareholders vote).

166. See, e.g., Martin Lipton, *Deconstructing American Business II*, BRIEFLY . . . PERSP. ON LEGIS. REG. & LITIG., Dec. 2006, at 1, 1–5.

167. Institutional shareholder voice has played an important role, for example, in the more shareholder-protective regime of the U.K. takeover code. See generally John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727 (2007); see also Armour et al., *supra* note 164, at 265–66.

168. See generally Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CAL. L. REV. (forthcoming 2018) (manuscript at 2-3), <https://ssrn.com/abstract=2930529> [hereinafter Fisch, *Governance by Contract*] (stating that “corporate participants are using private ordering to customize their corporate governance by adopting issuer-specific terms.”).

169. See Fisch, *Governance by Contract*, *supra* note 168, at 7, 9; see also *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 939 (Del. Ch. 2013) (stating that “the bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the DGCL.”).

advocate for corporate governance related voting rights to be encompassed within these contracts.<sup>170</sup> As scholars have noted, however, a “charter amendment would require board approval and therefore the same frictions that explain the negative returns for acquirer shareholders—overconfidence and moral hazard—might explain why we do not see such charter amendments.”<sup>171</sup> With respect to bylaws, the “scope of potential governance bylaws is very broad.”<sup>172</sup> While there is some question about whether a mandatory shareholder vote for significant acquisitions via bylaws would be permissible under Delaware law,<sup>173</sup> a bylaw which only provides a shareholder advisory vote for significant acquisitions may be less problematic as it would address the procedure by which the acquisition decision is made but would leave the board with final authority over the acquisition transaction.<sup>174</sup> Conceivably, shareholder advocacy, even for advisory votes in significant acquisitions, could play an important governance role and may eventually lead to more mandatory provisions.<sup>175</sup> In the relatively recent past, for example, advocacy by shareholders on issues such as majority voting for directors has resulted in boards voluntarily adopting majority voting regimes, as well as significant legislative changes in corporate law.<sup>176</sup>

#### IV. Conclusion

Large public company acquisitions often destroy value for the acquiring firm. Empirical literature suggests that the bidder overpayment problem is driven by behavioral biases of the bidder’s management or soft conflicts of

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170. See Verity Winship, *Shareholder Litigation by Contract*, 96 B.U. L. REV. 485, 497 (2016).

171. Becht et al., *supra* note 23, at 3064; see Fisch, *Governance by Contract*, *supra* note 168, at 7 n. 33.

172. See Fisch, *Governance by Contract*, *supra* note 168, at 8.

173. Whether changes in bylaws could effectively provide shareholders a voice in acquisition decisions would likely be subject to debate since bylaws are often viewed by courts as “procedural” and “process-oriented.” See *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 235 (Del. 2008); Fisch, *Governance by Contract*, *supra* note 168, at 19-20. There is some tension between the *AFSCME* case and other decisions of Delaware courts which have been much more open to the shareholders’ powers to amend bylaws. See Fisch, *Governance by Contract*, *supra* note 168, at 4.

174. See Fisch, *Governance by Contract*, *supra* note 168, at 16.

175. See Edelman et al., *supra* note 16, at 1369; see also Fisch, *Governance by Contract*, *supra* note 168, at 24 (arguing that proxy advisory firms have increased the focus on “board failures to respond to shareholder demands”).

176. See Armour et al., *supra* note 164, at 268.



interests on the part of bidder management where management seeks to extract private benefits from the deal. Several recent empirical studies suggest that voting rights for bidder shareholders in significant acquisition transactions will play an important role in reducing value-destructive acquisitions. This article argues that it is time for corporate law to respond to this literature and reassess bidder shareholder voting rights.