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Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties

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Abstract

When a bidding corporation succeeds in obtaining voting control of a target corporation through a hostile tender offer, many commentators argue that it is unfair to allow the bidder to exercise its voting power to set the price terms of a second-step takeout merger in which the bidder purchases the shares of the remaining target shareholders. This concern is inappropriate because it treats a unitary acquisition between adversaries as if it were two separate transactions–the second of which involves abuse of power by fiduciaries–and also because it assumes that shareholders of the target corporation are incapable of protecting themselves from the power of a successful bidder. Moreover, imposition of fiduciary rules may impose either prohibitive costs or absolute barriers to some takeovers, even if such transactions would be wealth producing. While there is a risk that some takeovers may exploit the "prisoner's dilemma" facing target shareholders threatened with an unattractive takeout threat, target shareholders are capable of responding to that threat with devices to coordinate their response. So-called "shark repellent" amendments that raise the proportion of votes required to approve second-step mergers or that limit the terms of such mergers can function as coordination devices to alleviate the prisoner's dilemma. Commentators' fears that such devices may unduly burden the market for corporate control appear to depend to a large extent on unfounded assumptions that all takeovers are wealth producing and that takeovers are never motivated by potential gains flowing from exploitation of the lack of coordination among target shareholders. However, empirical studies indicate that adoption of such coordination rules can benefit target shareholders and that it is unlikely that shareholders will approve voting rules so restrictive that they would preclude wealth-creating acquisitions. The usual notions of shareholder apathy are simply inapplicable to takeout mergers.