

Chapter 1

Acquiring a Publicly Traded Insurance Group

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§ 1:1 Introduction

The M&A transactions that garner the most public attention have been those involving acquisitions or combinations of publicly traded companies. In recent years, there has been a growing number of cross-border public M&A transactions, particularly driven by interest in specialty insurers and property and casualty reinsurers in Bermuda and in the Lloyd’s market, including:

- Acquisition of XL Group Ltd. by AXA SA (2018);
- Acquisition of Validus Holdings Ltd. by AIG (2018);
- Acquisition of Aspen Insurance Holdings Ltd. by Apollo Global Management (2018); and
- Acquisition of Endurance Specialty Holdings Ltd. of Bermuda by SOMPO Holdings, Inc. of Japan (2016);

The past few years also have been notable for major deals between U.S. health insurers, including the \$48 billion acquisition of Cigna Corporation by Anthem, Inc. and the \$37 billion acquisition of Humana, Inc. by Aetna Inc. in 2015. Both deals were terminated in 2017

after the U.S. Department of Justice successfully challenged the transactions on antitrust grounds, raising doubts whether consolidation in that segment will be possible. In November 2018, CVS Health Corporation, the pharmacy retailer and pharmacy benefit manager, completed the acquisition of health insurer Aetna Inc.

Other prominent public M&A transactions in the U.S. insurance sector announced since 2017 include the acquisition of Fidelity & Guaranty by CF Corporation, a special purpose acquisition company whose investors include funds affiliated with the Blackstone Group and Fidelity National Financial, and the pending acquisition of Navigators Group Inc. by Hartford Financial Services Group Inc. Until recently, insurers from China were active in outbound acquisitions, most notably the acquisition of Genworth Financial Inc. by China Oceanwide Holdings Group in 2016 (pending as of the date of publication), though steps by the Chinese government to reduce the amount of capital flowing out of the country in 2017 have significantly reduced Chinese involvement in public M&A.

The Bermuda insurance industry has also been notable for the growth in hostile deal activity in recent years. For example, the acquisition of reinsurer PartnerRe Ltd. by Italian investment company EXOR SpA in 2015 began with an unsolicited offer by EXOR after PartnerRe had announced a friendly “merger of equals” with another Bermuda insurer. Additional examples of hostile deal activity in Bermuda are described *infra* in section 1:6.

This chapter will briefly outline legal issues to be considered by a corporation (the acquiror) in connection with a possible acquisition of a corporation publicly traded in the United States or a U.K. listed company (in either case, the target) that owns insurance subsidiaries. The discussion includes acquisitions that have the support of the target’s management, as well as hostile deals. Acquisitions for cash and for stock are discussed.

§ 1:2 Preliminary Considerations

§ 1:2.1 Speed Is Less of a Factor with Insurance Targets

Parties usually structure acquisitions so that as little time as possible elapses between the announcement of a proposed acquisition and its consummation. Once a possible acquisition of a publicly traded company is announced, the transaction becomes vulnerable to competing bids, which may take the form of offers directly to the target’s shareholders, seeking to sidestep approval by the target’s management. In insurance M&A, though, speed from announcement to closing is less readily achieved because the acquisition of the target is subject

to inherent and often prolonged regulatory delays averaging three to six months or more. The delays inherent in acquisitions in regulated industries such as insurance place an even greater than usual emphasis (in the U.S. context, at least) on contractual protection against competing bids through a strong “no-shop” clause and a limited “fiduciary out” for the target’s board, as discussed below.

§ 1:2.2 Due Diligence

A potential acquiror of a publicly traded insurance company should expect to conduct a substantive business and legal due diligence investigation that goes far beyond the review of publicly available disclosure documents, regulatory filings and financial statements. A target in a negotiated transaction will usually assemble, either on its own initiative or at the request of a potential acquiror, a data room containing nonpublic information covering such core areas as: investments, actuarial analyses and reserve studies, key information technology arrangements, regulatory files, complaint logs and litigation files, reinsurance agreements, and agreements with key producers.¹ At the appropriate stage in the process, an acquiror should also expect to have access to senior members of the target’s management team, including the CEO, CFO, chief investment officer, chief information officer, chief actuary and general counsel. Legal due diligence will typically focus on identifying contingent liabilities, analyzing regulatory risks, and evaluating material contracts for change of control or merger provisions.

While it is true that publicly traded companies are required to disclose periodically information that they consider material to investors in their securities, it is very important that acquirors use their time in the data room and in management meetings to form their own independent view as to what material issues may lurk within a target. In most transactions, the acquiror’s obligation to close the transaction will be conditioned on the absence of any “material adverse effect” on, or “material adverse change” (MAC) to, the target’s results of operations or financial condition from the date of the last financial statements or the date of signing the merger agreement. The MAC standard in practice is set at a high level, however, and may not provide recourse for many issues that, had they been known to the acquiror before the merger agreement was signed, would have affected valuation. In the U.K., the ability of an offeror to rely on a MAC condition is significantly restricted by the regulatory regime. It is much in the parties’ interest to make a decision not to proceed with a transaction

1. For a discussion of insurance company due diligence issues, see section 2:2.

at the stage of due diligence, when the dealings between the parties remain confidential, rather than for a transaction to fall apart if adverse facts come to light after announcement.²

In the U.K., one important competing consideration is that, under the City Code on Takeovers and Mergers (the City Code), any information shared by the target with one bidder must, upon request, be made available to a competing bidder. This point needs to be taken into account by a bidder (and a target) when considering the scope of information to be requested as part of any due diligence exercise.

§ 1:2.3 Confidentiality and Disclosure Issues

Preliminary merger discussions and the ensuing due diligence investigation by the acquiror should take place under a confidentiality agreement. Although neither a U.S. public company nor a U.K. listed company has a duty to disclose preliminary merger negotiations (even though a merger, if it were to be announced, might clearly be material), the target may be obliged to announce discussions with the acquiror if rumors or unusual trading occur in the target's stock, or if the target seeks to access the capital markets during the negotiation period. Also, in the absence of a confidentiality agreement, disclosure of material information to the other party or its advisors could trigger an obligation to make a public disclosure under Regulation FD in the United States or under the Market Abuse Regulation or the City Code in the U.K. Accordingly, both the acquiror and the target should use every precaution to keep information about the transaction strictly confidential through dissemination of information only on a need-to-know basis and the use of code names. The working groups should be as small as possible, because of the need for confidentiality and because of the need for efficient decision making (particularly if a bidding contest or a hostile offer develops). Under the EU Market Abuse Regulation and related Disclosure Rules in the U.K., insider lists must be maintained by public companies and made available to regulators on request. These lists contain the names of persons working for a company (whether as employees or under contract) who have access to inside information relating directly or indirectly to the company. The rules also require a company to ensure that its outside advisors maintain confidentiality lists of staff and service providers who have access to inside information relating to the company.³

Most confidentiality agreements involving a publicly traded target also include a "standstill" provision, which is intended to prevent

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2. Section 1:5.2[F] discusses MAC clauses in more detail.
 3. Consumer privacy and data protection issues arising from the conduct of due diligence are discussed in section 2:2.

the prospective acquiror from launching a hostile bid for the target after it receives confidential information. The standstill typically prohibits the acquiror and its affiliates from making any tender offer, proxy solicitation or taking certain other hostile actions with respect to the target, and may prohibit any purchase of the target's securities, including purchases on the open market. In the United States, if the acquiror is itself a publicly traded entity, and especially if the target receives access to confidential information of the acquiror (for example, because the acquiror may use its stock as consideration for the acquisition), the target may make parallel covenants with respect to the acquiror (in the U.K., such target covenants are largely prohibited). The standstill period typically lasts for twelve to twenty-four months from the date of the confidentiality agreement.

§ 1:3 Structure of the Acquisition

§ 1:3.1 United States

[A] Steps in Unregulated Industries

It is worthwhile to compare the single-step merger approach most often employed for an insurance transaction with the alternate structure that would be common in an unregulated industry where no regulatory approval is needed other than U.S. antitrust approval.⁴ Because of the need for speed, acquisitions not subject to inherent regulatory delays can be accomplished in a series of steps that put the acquiror in control of the target more quickly than can be done by a merger:

- In some cases, initial acquisition of a stock position in the target.
- Cash tender offer for the target's shares. The documents for such an offer do not require prior Securities and Exchange Commission (SEC) approval, and such an offer does not require a shareholder vote by the target.
- Merger of the target with the acquiror (or a subsidiary of the acquiror) following the closing of the tender offer.

In a stock deal, a variation on this structure would be to substitute an exchange offer for a cash tender offer. An acquiror may commence

4. See generally MEREDITH M. BROWN, RALPH C. FERRARA, PAUL S. BIRD, GARY W. KUBEK AND WILLIAM D. REGNER, TAKEOVERS: A STRATEGIC GUIDE TO MERGERS AND ACQUISITIONS (3d ed. Aspen Law & Business, 2010).

an exchange offer without prior SEC approval, but it may not acquire the shares of the target that have been tendered until a registration statement for the acquiror's shares is declared effective.

Under this two-step front-end tender offer/back-end merger structure, absent a need for special regulatory approval, it is possible for the acquiror to acquire the target within approximately one month after beginning its tender offer for the target shares. By contrast, it would not normally be possible for the acquiror to consummate a single-step merger with the target, as the rules now are in effect, sooner than about three months after the acquiror and the target reach agreement on the terms of their transaction. This is because a merger will require the preparation of a proxy statement to be sent to the target's shareholders, containing detailed financial and narrative information about the target. Typically, it takes longer to prepare a draft of such a document than to prepare a cash tender offer, which usually contains only a brief paragraph about the target's business. Moreover, unlike a tender offer, a proxy statement must be filed with the SEC at least ten days before being sent in final form to the target's shareholders (and, in practice, it often takes longer to clear SEC staff comments), and, if the consideration involves securities of the acquiror, the SEC must declare effective the registration statement covering those securities before the transaction can close.

Therefore, a tender offer is usually the fastest way to acquire a publicly traded target in a non-regulated industry. However, as described in the next section, the requirement to obtain regulatory approval before acquiring an insurance holding company—and the attendant delays—usually leads the parties to choose a single-step structure.

[B] Single-Step Merger in the Insurance Industry

In the insurance industry, the acquiror cannot acquire control of the target until the acquiror has obtained the prior approval of the insurance regulator in each of the jurisdictions in which the target's insurance subsidiaries are domiciled or commercially domiciled. Control is presumed, under most states' laws, at 10% of the voting stock (in Alabama, the applicable threshold is 5%). Obtaining approval might take three months or more. Thus, even if the acquiror launches a tender offer as a first step in an acquisition of 100% of the common equity of the target, the acquiror cannot actually purchase more than 9.9% of the shares until it obtains this approval.⁵ The need for regulatory approval takes away any advantage of speed that a first-step tender offer would otherwise afford.

5. For a discussion of insurance regulatory approval requirements on a stock purchase, see chapter 5.

Moreover, the approval of the target's shareholders for a merger may be obtained before regulatory approval is granted. As discussed in section 1:5, the target's board has a duty to keep open the possibility of accepting a competing offer until shareholder approval is obtained. In contrast, there is no cutoff for a competing proposal if the transaction is structured as a tender offer until the deal is closed following receipt of regulatory approvals. As a consequence, not only is the speed advantage of a tender offer not typically present in an insurance industry deal, but a tender offer could actually leave the transaction exposed to interloper risk for a longer period.

For these reasons, in the insurance industry, acquisitions of publicly traded insurance groups are almost always structured as single-step mergers. Prior to any public announcement, the acquiror and the target negotiate a merger agreement, which is signed and immediately announced. The parties to the merger agreement are typically the target, the acquiror and a newly formed acquisition subsidiary of the acquiror (merger sub). Under the terms of the agreement, merger sub merges with the target, and the surviving company becomes a wholly owned subsidiary of the acquiror. The merger agreement may provide that the target's shareholders receive cash, acquiror shares, a combination of cash and shares, or, in a cash-election merger, an opportunity to elect whether to receive cash or shares.

As discussed above, since approval of the target's shareholders is a condition to consummation of the merger, the target would be required to send its shareholders a proxy statement containing, among other things, a full description of the target, full financial statements of the target, and enough information to enable the target's shareholders to make an informed decision as to whether to vote for or against the merger. The proxy statement would need to comply with the SEC's proxy rules and, if acquiror securities comprise all or part of the consideration, the SEC's rules for prospectuses.

It will be necessary to review the state corporation statute of the target's state of incorporation, as well as the target's charter, to see what vote by the target shareholders is necessary to approve the merger. If the target is a Delaware corporation, the Delaware statute requires that the merger be approved by holders of a majority of the target's outstanding stock entitled to vote on the merger. The target's charter may provide for a supermajority vote. The target's charter may also include preferred stock that has a class vote on a merger. Unless the target's charter or state law provides otherwise, the acquiror is permitted to vote its own shareholdings in the target in favor of the merger.

State corporation laws generally permit an acquiror to complete a "short-form" merger—that is, a merger approved by the acquiror's directors, without the need for any vote by the target's shareholders—if

the acquiror owns a specified amount of each class of the target's stock that would be entitled to vote on the merger. Until recently, the acquiror of a Delaware target could complete a short-form merger only if it held at least 90% of each class of the target's stock. However, the Delaware General Corporation Law (DGCL) was amended as of August 1, 2013, to permit a short-form merger where the acquiror owns the number of shares required to approve the merger under state law and the target's charter (generally 50%).⁶

Depending upon the applicable state law, those shareholders of the target who do not vote for the merger and follow specified statutory procedures may be entitled to seek appraisal, in which case they will be entitled to the judicially appraised price of their shares (which may be more or less than the merger price). Appraisal may not be available if the merger consideration consists of shares of a publicly held company.

§ 1:3.2 United Kingdom

[A] The City Code on Takeovers and Mergers and the Takeover Panel

In the U.K., takeover offers for public companies (including public companies whose shares are not listed and also private companies if any of their securities have been publicly traded in the preceding ten years) are regulated by the City Code, which is a set of regulations promulgated by the Panel on Takeovers and Mergers (the Panel).

The City Code principally applies to takeover offers for companies which have their registered offices in the U.K., Channel Islands or Isle of Man and which have any securities admitted to trading on a regulated market or a multilateral trading facility in the U.K. or on any stock exchange in the Channel Islands or the Isle of Man. The City Code may also apply to companies with registered offices elsewhere in the EEA if their securities are admitted to trading on a U.K. regulated market.

Following the implementation of the European Directive on Takeover Bids, the Panel is designated by law as the supervisory authority to carry out certain regulatory functions in the U.K. in relation to takeovers, principally: (i) the issuance, review and amendment of the City Code; (ii) the enforcement of the City Code through the Hearings Committee of the Panel; and (iii) the supervision and regulation of takeovers, consultation on the City Code, advice on interpretation of the City Code and the giving of rulings on the interpretation, application or effect of the City Code through the Panel Executive. Appeals

6. DGCL § 251(h).

against rulings of the Hearings Committee of the Panel are heard by the Takeover Appeal Board, an independent body whose Chairman and Deputy Chairman will usually have held high judicial office. Although the proceedings of the Panel are open to judicial review by the courts, there have been very few occasions (and none in recent years) in which the courts have overturned Panel decisions.

As a result of the U.K.'s implementation of the European Directive on Takeover Bids, rulings of the Panel now have binding legal effect, parties to a takeover offer subject to the City Code and the jurisdiction of the Panel are not able to bring legal action against each other for alleged breaches of the City Code (thus eliminating court-based takeover tactics), and once a takeover has been implemented in accordance with the City Code it may not be rescinded.

The City Code enshrines a set of General Principles designed to set standards of behavior to ensure fair and equal treatment for all target shareholders. The General Principles are then developed into the detailed Rules of the City Code. The General Principles and the Rules include specific "equal treatment" principles:

- All holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected.
- The holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business.
- The board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.
- False markets must not be created in the securities of the offeree company, of the offeror company or of any other company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted.
- An offeror must announce a bid only after ensuring that it can fulfill in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.

- An offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.

Notwithstanding the detail of the Rules, the City Code is clear that it is to be followed in spirit as well as in letter.

The City Code sets out a detailed time frame during which takeover offers are to be conducted with specific dates by which any offer documentation is to be posted to target shareholders and rules as to the content of such documentation; in particular, the City Code requires that, for an offer to be successful, a minimum level of acceptances must have been received from the target's shareholders by no later than the sixtieth day after the posting of the offer document.

There are key provisions within the City Code which enhance the importance of bidders making takeover offers only if they are prepared to be bound by them and submit themselves to the risk that a takeover offer may fail on the public stage or trigger a competing bid from a rival bidder. These include:

- Restrictions on the ability of the offeror (and those acting in concert with it) to deal in shares of the target during the offer period.
- Restrictions on the ability of the offeror to withdraw or amend the terms of its offer for the target once announced.
- Restrictions on the content of announcements to be made by either the offeror or the target during the course of the offer, and requirements as to content of any announcements, advertisements or shareholder circulars.
- A requirement for a cash offeror to have certainty of funding in place before it announces its offer.
- In the event of a failed takeover offer for the target, a prohibition on the offeror making a fresh takeover offer for the target in the ensuing twelve-month period.

The Panel (particularly in the light of the European Directive on Takeover Bids) has the right to report non-compliance to regulatory bodies throughout the EU, particularly to the Financial Conduct Authority (FCA) in the U.K., which may consider any non-compliance by regulated entities when reviewing their standing as persons authorized by the FCA. It should also be borne in mind that if the target is an authorized U.K. insurer, then the offeror will be required to obtain prior approval from the Prudential Regulation Authority (PRA) and/or the FCA in order to become the holder of 10% or more of the target

and the takeover offer will therefore have to include conditions (or pre-conditions) as to the obtaining of all necessary regulatory consents and approvals, including from the PRA and/or the FCA.

[B] Recommended Offer Followed by Compulsory Acquisition

The vast majority of takeover offers in the U.K., whether for insurers or other entities, are carried out through a takeover bid which is recommended to the shareholders of the target by the board of the target. Although a recommended bid may have started off following a friendly (or hostile) approach by the offeror to the board of the target, it is unusual in the U.K. (for the reasons explained in section 1:6 below) for a hostile offer to be made, particularly in the case of a U.K. insurer where any takeover offer will require prior regulatory approval by the PRA and/or the FCA and may also raise competition issues either at the U.K. national level or under European merger control regulations.

It is a fundamental rule of the City Code that absolute secrecy must be maintained until a takeover offer is publicly announced. Information must only be passed on a need-to-know basis and in confidence prior to any announcement, and the City Code requires that a takeover offer must be put forward initially to the board of the target. The City Code specifies the circumstances in which an announcement about the offer must be made; these include the obligation to announce immediately after a firm intention to make an offer has been communicated to the board of the target (even if the board is inclined to reject the approach) and also where the target is the subject of bid rumor or speculation, there are untoward movements in the share price of the target, or the negotiations and exchange of information preceding any announcement have extended beyond a tight-knit group comprising the prospective offeror and the target, and their close advisers.

In a recommended takeover offer, once the offeror's proposal is accepted the takeover offer will be announced by joint announcement made by the boards of the offeror and the target, setting out the key terms and conditions of the offer, which will subsequently be posted (in the form of an offer document) to shareholders of the target. Given that at this stage the key terms and conditions of the offer will have been agreed and published (particularly the detailed terms and conditions as to acceptance levels and regulatory or other conditions), there is little room for subsequent maneuver by the parties, absent the intervention of a third-party competing bidder or a material change in circumstances, in which case the Panel may allow either party to seek to change terms. For this reason, it is not usual in a U.K. recommended takeover bid to find a merger agreement being negotiated or signed between the parties (as is typical in the United States) because

the core terms are already settled and announced at the initial stage. Furthermore, the City Code significantly limits what can be included in any such agreements, effectively ruling out deal protection provisions which favor the offeror at the target's expense.⁷

Following the announcement, the offeror then has twenty-eight days to prepare the formal offer document (containing the information required by the City Code) and dispatch this to the shareholders of the target. The offer document is the mechanism under which the offeror makes a formal contractual offer to target shareholders in a manner that they can accept by completing and returning the form of acceptance. Once the offer document has been posted, the parties may wait (nervously) to see whether a third-party competing bidder chooses to intervene. Barring such intervention, however, the recommended offer must remain open for a minimum of twenty-one days during which time either the conditions to the offer (including as to the level of acceptances) are met or (if not met by day twenty-one) the offer will be extended up to no later than day sixty (in respect of satisfaction of the acceptances condition) and day eighty-one (in respect of satisfaction of all other conditions). In the course of the offer, provided it has not limited its ability to do so by issuing a "no revision" statement, the offeror will be able to improve the terms offered to target shareholders at any time (but not beyond day forty-six if the offer is hostile) during the offer timetable.

In order for a takeover offer to be successful, acceptances must be received from a minimum percentage of target shareholders. This will be a specific condition to the terms of the offer, and must be set at a level of above 50%. This condition must be satisfied within sixty days of the posting of the offer document, failing which the City Code provides that the takeover offer will lapse (unless the Panel grants an extension). The level of acceptances is a key condition of the takeover offer since, although a 51% acceptance level by target shareholders would give the offeror effective control of the target and the ability to remove its board of directors and replace them with appointees of the offeror, only if an acceptance level of 90% is reached can the offeror effect a compulsory "squeeze out" of the dissenting minority shareholders who have not accepted the takeover offer. To this end, it is usual for a takeover offer to be framed so as to include an acceptance condition of 90% but giving the offeror the right to lower that percentage during the course of the offer when the likely level of acceptances becomes clearer so as to close the offer soonest and keep out competitors. Assuming that the offeror reaches the acceptance condition

7. See *infra* section 1:5.1.

and that this is set at 90% and is reached not later than day sixty (so the takeover offer is not required to lapse) the offeror will then be in a position to effect the statutory “squeeze out” of the target’s remaining minority shareholders as provided by sections 974 to 991 of the Companies Act 2006.

Under the “squeeze out” provisions, a statutory mechanism is provided whereby the offeror is given the right to buy out the minority at the price offered to target shareholders under the takeover offer; likewise, the minority shareholders who are comprised within the 10% or less of the target and did not accept the takeover offer have the right to require the successful offeror to buy them out at the price offered for shares under the takeover offer. Although the statutory framework is simple in concept and in the mechanics required for the service of statutory buy-out notices, there are pitfalls that may sometimes trap the unwary offeror. For instance, the 90% level is not set at 90% of the total shareholder base of the target but at 90% of the shareholder base “*to which the takeover offer relates*”; hence, the offeror will have effectively excluded from the 90% pool any target shares already held by the offeror or its associates since these shares will not be subject to the takeover offer (and so the pool comprising the 90% of shares is made smaller). In addition, in order to catch overseas shareholders, the offeror will have to find a means to communicate the takeover offer to, and have it made available to, overseas shareholders since failure to include overseas shareholders of any particular category will again lessen the pool of shares on which the 90% test will be calculated.

In the event that a successful offeror is unable to take advantage of the compulsory “squeeze out” provisions, an alternative method of obtaining absolute ownership of the target is to effect a scheme of arrangement under part 26 of the Companies Act 2006, under which the remaining minority shareholders can, provided enough of them vote in favor and court approval is obtained, have their shares purchased at a price which need not be the same, and on terms which need not be the same, as those applicable in the original takeover offer.

[C] Scheme of Arrangement

As mentioned above, there is a statutory procedure for the acquisition of shares in a U.K. public or private company which enables a takeover to be effected and (as described above) a process to be employed in conjunction with a takeover offer to acquire the shares of a dissenting minority.

Schemes of arrangement have grown in popularity since they require approval of holders of fewer shares to acquire 100% of a target in a takeover.

A scheme of arrangement is a statutory procedure which allows a target to make an arrangement or compromise with some or all of its shareholders, although the City Code will still apply. It is therefore difficult to carry out a takeover offer by way of a scheme of arrangement unless the takeover is recommended by the target's board of directors because the terms and implementation of the scheme will be entirely in the hands of the board of the target. A scheme of arrangement has a number of advantages over a "usual" recommended contractual takeover offer:

- For a scheme of arrangement to be effective, it must be approved by a resolution of a majority in number of target shareholders present and voting either in person or by proxy at a Court Meeting, representing 75% or more in value of the target's shares; provided it is approved by not less than this percentage level all shareholders of that class will be bound, hence delivering 100% of the target to the bidder. This contrasts with the higher threshold of 90% which the bidder will have to reach under a takeover offer in order to be able to employ the Companies Act minority "squeeze out" provisions. Importantly, however, target shares already held by the bidder cannot be voted at the Court Meeting.
- In assessing the 75% threshold for a scheme of arrangement, only those shareholders who actually vote (in person or by proxy) at the relevant shareholders meeting are taken into account.
- While a recommended contractual takeover offer can take up to eight and a half months before the bidder actually acquires 100% of the target, under a scheme of arrangement the overall timetable will often be shorter (although typically a controlling stake can be achieved more quickly under a contractual takeover offer).

Other advantages in employing a scheme of arrangement include the wide discretion given to the court to make ancillary orders, and the fact that the U.K. legal prohibitions on the giving of financial assistance by public companies or by private company subsidiaries of public companies (under sections 677 to 683 of the Companies Act 2006) will not apply to any assistance which is approved by the court (thus giving wider scope for utilizing the target's assets or as to payment of costs). The very fact of there being court hearings, however, clearly gives a forum for any vocal shareholder minority to hold out against the scheme; as well as attracting publicity for the minority's case, the court will be obliged to consider whether the scheme treats shareholders fairly.

Until recently, a scheme of arrangement (if structured correctly) could be used to avoid the 0.5% U.K. stamp duty tax on consideration payable for the target's shares. However, recent changes to the relevant regulations mean that there is no longer any stamp duty saving benefit to using a scheme as opposed to a contractual offer.

§ 1:3.3 Cross-Border Acquisitions

Non-U.S. acquiring companies have typically preferred to acquire U.S. companies for cash. In general, this is because the acquiror, if not otherwise subject to the U.S. securities laws as a publicly traded company, does not wish to become subject to those laws, as would normally be the case if the acquiror were to acquire the target for shares of the acquiror. Moreover, there can be a "flow-back" problem which can depress the market for the acquiror's shares, if the target's U.S. stockholders do not wish (or are unable) to own shares of non-U.S. companies and therefore sell the acquiror shares they receive in the merger. Additionally, in cases where the acquiror is organized as a mutual insurer, such as the acquisitions of StanCorp Financial Group, Inc. and Symetra Financial Corporation by Japanese mutual insurers announced in 2015, the acquiror has no legal power to issue stock and therefore must execute the transaction using cash.

In recent years, however, some non-U.S. acquirors have followed the U.S. trend by issuing common equity as the merger consideration in an acquisition by merger of a U.S. publicly traded company. In such cases, the acquiror either is already a U.S. reporting person, so that it can easily register its shares under the U.S. Securities Act of 1933 (the Securities Act), or has been willing to register its shares under the Securities Act and become subject to reporting requirements and possible legal exposure under the U.S. securities laws. Benefits of a stock transaction include:

- It eliminates any need for cash borrowing or use of excess cash to complete the transaction.
- The transaction can be structured as a merger that is tax-free to the target and to its shareholders who receive the acquiror's shares or ADRs.
- It makes possible low or no-premium transactions that achieve fair sharing of synergies.

[A] SEC Requirements—Stock As Consideration

In the eyes of the SEC, an acquisition of a U.S. public company for stock of the acquiror is viewed as a public offering of acquiror stock, in that the shareholders of the target would be asked to make an investment decision whether to exchange their investment in the

target for shares of the acquiror. To complete a stock-for-stock merger, the acquiror would need to register its shares under the Securities Act. A U.S. acquiror would use Form S-4 to register the shares, while a non-U.S. acquiror would register its shares on Form F-4, and be liable to the target's shareholders for non-disclosures or omissions in the offering materials. Until 2007, non-U.S. companies were required to present their financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) or, alternatively, in accordance with their home-country accounting principles, with a reconciliation of these accounting practices to U.S. GAAP. In 2007, however, the SEC began permitting non-U.S. companies instead to present their financial statements in accordance with IFRS in the form published by the International Accounting Standards Board (IASB) (as opposed to IFRS as adopted in the home country, to the extent it differs from IASB standards). Accountants and legal counsel should be consulted at an early stage of planning for an acquisition where the consideration will be paid in shares, to determine what pro forma and historical financial statements of the acquiror would need to be included in the registration statement and the time required in preparing them.

The acquiror, once it lists its stock on a U.S. securities exchange, would be subject to reporting requirements. However, the SEC rules accommodate the unique circumstances of a non-U.S. issuer in several ways, imposing less burdensome reporting requirements than those applicable to U.S. issuers.

The content and timing of reports and notices that the acquiror would file with the SEC would differ in several respects from the reports and notices that the target or another U.S. issuer would file. The acquiror would be a "foreign private issuer" for the purposes of the reporting rules under the U.S. Securities Exchange Act of 1934 (the Exchange Act). If the target were a U.S. reporting company, it would file with the SEC, among other reports and notices, (i) an annual report on Form 10-K within ninety days after the end of each fiscal year, (ii) quarterly reports on Form 10-Q within forty-five days after the end of each fiscal quarter, and (iii) reports on Form 8-K upon the occurrence of certain material events. For targets that are "large accelerated filers," or "accelerated filers," the timing requirements for filing Form 10-K are reduced to sixty days and seventy-five days, respectively, after the end of each fiscal year; for both types of filers, the Form 10-Q must be filed within forty days after the end of each fiscal quarter. As a foreign private issuer, pursuant to the requirements of the Exchange Act, the acquiror would be required to file with the SEC an annual report on Form 20-F within four months after the end of each fiscal year and furnish reports on Form 6-K upon the occurrence of certain material events.

As a U.S. reporting company, the target must provide to its stockholders in advance of each annual meeting of stockholders an annual report containing audited financial statements and a proxy statement that complies with the requirements of the Exchange Act. As a foreign private issuer, the acquiror would be exempt from the rules under the Exchange Act prescribing the furnishing and content of annual reports and proxy statements to its shareholders. The New York Stock Exchange and other exchanges impose various requirements for annual reports, however, and many listed foreign issuers nonetheless provide annual reports to their shareholders.

In addition, as a foreign private issuer, the acquiror would be exempt from the provisions of the Exchange Act that require officers, directors and 10% shareholders to file reports with the SEC disclosing transactions in its common shares and disgorge profits realized from any purchase and sale of its common shares within six months.

The Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) imposes significant disclosure requirements on public companies and their chief executive officers and chief financial officers, and increases the penalties for violations of the securities and other laws. Many of the provisions of Sarbanes-Oxley are applicable to both domestic and foreign issuers, including those requiring the CEO and CFO of a company to certify financial reports. It also creates a federal crime for false certifications as to the financial condition and operations of the issuer, with penalties ranging from a \$1 million fine and ten years in prison for knowing violations to a \$5 million fine and twenty years in prison for willful violations. In response to Sarbanes-Oxley, the New York Stock Exchange and Nasdaq significantly strengthened their corporate governance requirements, particularly regarding board and audit committee practices. However, foreign issuers are allowed to follow home-country practices and law rather than these requirements in many cases.

[B] Other SEC Considerations

In addition to the registration requirements described above for the issuance of stock as consideration in a merger or other takeover, a cross-border acquisition involving a U.S. insurance company faces other U.S. securities laws requirements, including:

- If the target is a U.S. domestic company and its shareholders will need to vote on the transaction, the transaction will need to comply with the proxy rules under Regulation 14A of the Exchange Act, including the need to provide a proxy statement (usually the same disclosure document as the registration statement) to shareholders.

- A cash tender offer or share exchange offer will need to comply with the U.S. tender offer rules under Regulation 14D (if the target's shares are registered under the Exchange Act) and Regulation 14E. These impose substantial requirements on the manner and timing of the offer, many of which are often inconsistent with requirements in other jurisdictions. For transactions where the target is a foreign private issuer and U.S. ownership interest by U.S. holders of the target is 10% or less (called "Tier I" companies), many of these restrictions fall away. For companies with U.S. ownership of between 10%–40% (called "Tier II" companies), a smaller number of restrictions are disapplied. Even if the transaction does not fit within one of these exemptions, however, it may be possible to obtain no-action relief from the SEC where the U.S. tender offer requirements are inconsistent with the legal and regulatory requirements of the home jurisdiction of the target.

§ 1:4 Other Legal Considerations

The acquiror's counsel should review, at an early stage in the acquiror's consideration of a proposed acquisition of the target, whether there are any legal or regulatory matters that may impede the acquisition. Apart from the panoply of U.S. state insurance holding company regulations and change of control filings outside of the United States,⁸ other matters to be considered include antitrust/merger control approval, restrictions on government ownership of U.S. insurance businesses, regulatory termination fee and other requirements.

§ 1:4.1 Antitrust/Merger Control Approval

Insurance mergers and acquisitions seldom raise substantive antitrust issues unless the transaction involves specialty markets with few participants. Nonetheless, antitrust merger control laws and, in the United States, state insurance holding company acts, require the acquiror to make filings that allow government officials to review the competitive impact of the merger.

Depending on the size and nature of the acquisition, it may be necessary to report a transaction involving a U.S. business in advance to the U.S. antitrust agencies under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the HSR Act). The HSR Act gives the antitrust agencies time to review a proposed acquisition for anticompetitive effects prior to consummation.

8. Discussed in detail in chapter 5.

Aside from ensuring compliance with HSR Act notification requirements, the acquirer and its counsel should consider whether the proposed acquisition raises any substantive antitrust problems. The transaction's effect on competition is also a criterion under state insurance holding company acts, not only in the states of domicile and commercial domicile of the operating insurance subsidiaries, but also in other states where the insurers are licensed if the post-transaction market share in any line of business exceeds specified thresholds in those states.⁹

The acquirer and its counsel must also consider whether the proposed acquisition might be subject to mandatory merger control notification and approval in other jurisdictions. In Europe, for example, the transaction will be subject to review under the EU Merger Regulation if the acquirer and the target have, in their most recent preceding financial year for which audited accounts are available, derived enough "turnover" from customers in the EU to meet the applicable thresholds for the transaction to have a "Community dimension." For insurance companies, the value of gross premiums written (including also reinsurance premiums, and after deduction of taxes and parafiscal contributions or levies) is used in place of turnover from sales of products or services.

If the parties' turnover does not meet the Community dimension thresholds, the transaction may instead be subject to national level merger control review in one or more of the twenty-eight EU Member States, assuming the parties meet the thresholds defined in the merger control regimes of the countries in question.

This basic principle as to allocation of jurisdiction is, however, subject to certain exceptions. That includes the possibility of the parties to a transaction that does not have a Community dimension, but which does qualify for merger control review in three or more EU Member States, to request the transaction be handled exclusively by the European Commission instead of being reviewed at a national level. Such request will be granted unless one of those Member States objects. The EU Merger Regulation also makes provision for transactions that have a Community dimension to be re-allocated to the national competition authorities in certain circumstances.¹⁰

9. For a discussion of "market share" statutes, see section 5:2.2[B].

10. A more detailed discussion of antitrust/merger control issues in insurance acquisitions is included in chapter 6.

§ 1:4.2 Restrictions on Government Ownership of U.S. Insurance Businesses

Some non-U.S. acquirors are entirely or, more commonly, partially state-owned. Many U.S. states prohibit the licensing of an insurer that is government-controlled. In recent years, these laws have in many cases been relaxed by amendments that have changed the old, absolute prohibition into a prohibition that applies only if the acquiror is both state-owned and benefits from a subsidy.

Non-U.S. bidders have been able to proceed with acquisitions of U.S. targets despite foreign ownership restrictions under state laws by developing mechanisms to insulate non-U.S. owners, directors and managers from operational control of the restricted business. This may be accomplished, for example, by conducting the restricted operations through a free-standing subsidiary of the target and executing a trust or proxy arrangement under which U.S. citizen directors maintain control over the subsidiary. Achieving this result, including necessary government approvals, in the time-sensitive context of a merger can be quite complicated. In other cases, where the government ownership of the acquiror is a minority position only, the acquiror may apply for a determination by the state insurance regulatory authorities that the target will not be deemed to be controlled by any non-U.S. government.

§ 1:4.3 Regulatory Termination Fee

With the entry of Chinese acquirors into the U.S. insurance M&A market, targets have sought new ways to protect against the execution risk associated with conditioning a deal on approval of the acquiror's home-country regulator. The China Oceanwide acquisition of Genworth Financial Inc., announced in October 2016 and pending at the time of publication, is notable for China Oceanwide's agreement to pay a fee to Genworth if the transaction is terminated due to regulatory barriers in China, Hong Kong, Macau or Taiwan. Specifically, China Oceanwide would pay the fee if the merger agreement is terminated when all conditions to closing are satisfied except for receipt of required approvals from regulators in any of those jurisdictions, or if any such regulator otherwise enjoins the transaction.

The amount of the termination fee was \$210 million, which represented 7.8% of the purchase price and double the "break-up" fee payable by Genworth to the acquiror in the event Genworth's board accepts a superior acquisition proposal. (See section 1:5.2[C] for a discussion of break-up fees.) The acquiror funded the fee amount into an escrow account upon signing of the merger agreement.

§ 1:4.4 Other Requirements

Does the acquiror intend to acquire a U.S. bank or bank holding company or a primary dealer in U.S. government securities? If so, approval of the U.S. Federal Reserve will be required.

Even if none of these restrictions is applicable, the acquiror, if it is not a U.S. company, will need to bear in mind the need to comply with reporting requirements under the International Investment and Trade in Services Survey Act if the acquiror acquires 10% or more of the target's voting securities. As mentioned above, if the target is an authorized U.K. insurer, the offeror will be required to obtain prior approval from the PRA and/or the FCA in order to become the holder of 10% or more of the target.

In addition to the merger control laws discussed above, are there laws of other jurisdictions that may affect the acquiror's ability to acquire the target? Will the acquisition have to be approved by the acquiror's shareholders?

Finally, if the target insurance company is a U.S. life insurer that has separate accounts that underlie variable life insurance policies and variable annuity contracts, an acquisition of control of the insurer may require further approvals under U.S. securities laws.¹¹

§ 1:5 Protecting the Deal

As noted above, the need to obtain state insurance and other regulatory approvals for the acquisition of an insurer can lead to a lengthy period between signing and closing. As a result, the acquiror will typically insist on putting in place as many "deal protection" devices as it can achieve during negotiations to protect itself against competing bids. In many cases, the target will have a common interest with the acquiror in deterring opportunistic bids that would disrupt a fully negotiated transaction. The following section of this chapter reviews the range of merger agreement provisions and ancillary documents that are commonly used in insurance M&A transactions to discourage disruption of a transaction by a third-party bid, and the potential limits to their application.

§ 1:5.1 General: Deal Protection and the Duties of the Board

Before adopting any of the deal protection devices discussed below, the target's board of directors will need to consult closely with counsel as to whether, individually or in cumulative effect, these measures would result in a violation by the directors of their fiduciary duties to

11. For a discussion of these approvals, refer to section 5:4.8.

the company or its shareholders. Particularly for a Delaware corporation, these considerations may be affected by whether the proposed transaction is for cash or otherwise results in a sale of control, whether the company adopts these measures before or after a competing bid has emerged and whether there has been an auction or other form of market check regarding the sale of the company. The strongest case for a full complement of protective measures can be made in a true stock-for-stock merger of equals in which no single stockholder gains a controlling stake in the combined company. In these transactions, Delaware courts have recognized that directors have broad discretion in pursuing long-term strategic objectives and, accordingly, have upheld reasonable protective devices designed to protect a transaction from third-party disruption.

Where corporate control is at stake, Delaware courts have recently held the board's decision-making process—and the role of its outside advisors—up to more exacting scrutiny. In a series of recent cases, the Court of Chancery has criticized financial advisers for conflicts of interest and found that such conflicts may amount to aiding and abetting breaches of the board's fiduciary duties. Most recently, in a decision affirmed by the Delaware Supreme Court, the court found that a board had breached its fiduciary duties—and its financial adviser had aided and abetted the breach—where (i) the adviser had an undisclosed conflict of interest due to its attempts to provide financing to the prospective buyer, (ii) critical financial information was provided to the board without sufficient time before the board vote approving the transaction for the directors to adequately evaluate the materials, (iii) certain changes were made to the advisers' valuation metrics that made the buyer's offer seem more favorable without sufficient explanation, and (iv) certain directors had personal reasons for favoring a quick sale.¹² The fact-intensive analyses undertaken by the Court of Chancery in these decisions underscore the importance of a carefully designed and implemented sale process.

Under English law, the directors of a U.K. target must consider their duties, obligations and liabilities from a number of sources, including common law, U.K. statute, the City Code and the U.K. Listing Authority's Listing Rules, Disclosure Guidance and Transparency Rules. The Companies Act 2006 sets out a statutory statement of directors' duties:

12. See *In re Rural Metro Corp. S'holders Litig.*, 88 A.3d 54 (Del. Ch. 2014), *aff'd sub nom.* RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015); see also *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011); *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432 (Del. Ch. 2012).

- Section 172 of the Companies Act 2006 has replaced a director's fiduciary duty to act in good faith in the best interests of the company. A director must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In so doing, the director must have regard to a number of factors such as the interests of employees, the long-term consequences of any decision and the need to act fairly as between members of the company.
- Section 173 of the Companies Act 2006 provides that a director must exercise independent judgment.
- Section 174 of the Companies Act 2006 codifies the commonly accepted understanding of a director's duty of care, skill and diligence.
- Section 175 of the Companies Act 2006 sets out a fiduciary duty to avoid conflicts of interest.

The Companies Act 2006 does not contain all the necessary details on directors' duties, and common law rules and equitable principles will need to be considered in interpreting and applying the general duties.

The City Code sets out a number of requirements in relation to the responsibility of directors of both the target and the acquiror, including as to taking responsibility for the conduct of the offer generally and in relation to particular documents as well as to ensuring the equal and fair treatment of all of the target's shareholders. The City Code also contains a specific prohibition on the board of the target taking any action during the course of an offer which might frustrate that offer, unless such action has first been approved by the target's shareholders.¹³

The City Code also contains a general prohibition on deal protection measures (including break-up fees). This prohibition is broadly drafted and precludes the target and its concert parties from entering into any "offer-related arrangement" with either the bidder or its concert parties during an offer period or when an offer is reasonably in contemplation. The focus is on the target here; the prohibition does not generally apply to covenants provided by the bidder in favor of the target (such as a reverse break-up fee). In addition, there are some narrow exceptions to the general prohibition, which would permit, for example, undertakings in relation to confidentiality and non-solicitation of employees and customers, as well as undertakings to provide relevant

13. See *infra* section 1:6.2[C].

information or assistance for the purposes of obtaining any official authorization or regulatory clearance.

Directors of a U.K. listed target must also be aware of the insider dealing and market abuse offenses under the Market Abuse Regulation and the Criminal Justice Act 1993 and the offenses contained in the Financial Services Act 2012 concerning misleading statements and market manipulation, which can carry both criminal and financial penalties.

§ 1:5.2 Deal Protection Devices in U.S. Acquisitions

[A] No-Shop Covenants; Fiduciary Outs

This common covenant in U.S. merger agreements typically provides that one or both parties to the merger will not, subject to certain exceptions, encourage, seek, solicit, provide information to, negotiate with or enter into a merger agreement with third-party bidders. The “no-shop” covenant consists of two elements: a “no-solicit” clause, which bars the target from soliciting competing bids, and is generally made flat, without a “fiduciary out”; and what is sometimes referred to as a “no-talk” clause, which bars the target from furnishing information to and entering into discussions with unsolicited competing bidders, which usually is made subject to a “fiduciary out.” The “fiduciary out” is a proviso that permits the board to take the prohibited actions if not doing so would involve a violation of its fiduciary duties. There may also be a fiduciary out enabling the target to terminate the merger agreement to accept a competing bid. The price for this latitude is generally the requirement that the target pay a termination fee to the acquirer.

A number of transactions in recent years have included “go-shop” clauses, which allow the targets to solicit competing bids for a limited period after signing a merger agreement, often with a reduced termination fee payable by the target if it terminates the merger agreement to accept a competing bid arising during the go-shop period.

An interesting alternative to a go-shop was used in the 2014 merger agreement between Dai-ichi Life Insurance Company Ltd. and Protective Life Corp. In that agreement, the parties agreed to an initial twenty-five-day “solicitation and early signing period,” during which Protective was free to solicit alternative proposals and provide confidential information to prospective bidders. Following that initial period, Protective was subject to a customary no-shop (subject to a fiduciary out) with a relatively low termination fee: approximately 2.4% of the purchase price.

In its more restrictive formulation, the “fiduciary out” provision can be qualified by numerous conditions, including: (i) that the third-party initiative be in the form of a bona fide written offer that either

is not subject to a financing condition or, in the opinion of the board's financial adviser, is financeable; (ii) that the third-party offer be "superior" from a financial point of view; (iii) that the third party be required to enter into confidentiality and standstill agreements before receiving any information; (iv) that the original merger partner be fully informed of all discussions with the third party, and be afforded time and an opportunity to match any competing offer; and (v) that the board take such action only following receipt of advice from outside counsel. The fiduciary outs typically apply only until the shareholders of the target have approved the merger.

While some Delaware cases have upheld flat "no-solicit" provisions which prohibit a merger party from soliciting alternative transactions, Delaware courts have been critical of so-called "no-talk" provisions in no-shop clauses, which prohibit a merging party from providing information to or negotiating with potential third-party bidders. The courts emphasized the duty of the target's board to act in all cases on an informed basis and suggested that bargaining away the board's ability to inform itself about a competing bid—even if only to form a basis for rejecting the bid—could constitute a breach of duty.

Under the Delaware cases, if the agreement involves a change of control which triggers the duty of the board to obtain the best price reasonably available (the so-called *Revlon*¹⁴ duty), a flat no-talk covenant could be inconsistent with that duty. One recent Delaware decision suggests that even a no-shop with a fiduciary out might not be enough to establish the board's fulfillment of its fiduciary duties, where the period between signing and closing the transaction is too short to reasonably allow for the emergence of an alternative bidder and the pre-signing sale process otherwise was not properly designed to maximize shareholder value.¹⁵ And, even in a stock-for-stock merger of equals not implicating *Revlon* duties, a flat no-talk provision, at least in Delaware, may be inconsistent with the fiduciary duties of the directors of a party to a merger—in particular, the duty to be informed.

It is worth pointing out that the law of states other than Delaware may differ from Delaware law with respect to the duties of directors.

[B] Forcing a Stockholder Vote

Sometimes an acquiror will seek a firm commitment by a target board to submit the merger agreement to the stockholders for a vote, even if the target's board no longer recommends the transaction. Such a provision was included in the 2015 merger agreement between

14. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

15. See *Kochler v. NetSpend Holdings, Inc.*, 2013 WL 2181518 (Del. Ch. 2013).

Nassau Reinsurance Group Holdings, L.P. and The Phoenix Companies, Inc. The DGCL expressly permits a board to submit a merger agreement—or any other matter requiring a vote—to stockholders with a negative recommendation. In cases where a target board is required to take a proposed merger to a stockholder vote, the ability of the board adequately to inform itself as to the terms of competing bids—underscored by Delaware cases critical of “no-talk” clauses—becomes even more important.

This was made abundantly clear by the Delaware Supreme Court’s decision in April 2003 in *Omnicare, Inc. v. NCS Healthcare, Inc.*¹⁶ The court in that case struck down a fully locked-up merger agreement and essentially adopted a bright line requirement that directors of Delaware target companies must negotiate an effective “fiduciary out” in merger agreements, subject to stockholder approval. In that case, the merger agreement included a provision that the merger be submitted for stockholder approval, even if the board of the target no longer recommended the bid. At the time the merger agreement was signed, target holders with a majority of the voting power committed to vote for the transaction. Together, these two provisions, insisted upon by the acquiror, guaranteed that the transaction with the acquiror would be approved, even if a better bid appeared before the target stockholder meeting to vote on the merger.

The court found these arrangements were not a reasonable response to a threat, under the *Unocal*¹⁷ proportionality test, which examines whether a board’s response to a reasonably perceived threat was reasonable in relation to the threat. The court also found the lock-up to be invalid because it prevented target directors from exercising their continuing fiduciary duties to stockholders. According to the court, the board was “required to contract for an effective fiduciary out clause to exercise its continuing fiduciary responsibilities.”

Recent Delaware case law provides one possible route to increased deal certainty, at least where there is a controlling target stockholder and the target’s stockholders can act by written consent: the merger agreement can provide a termination right to one or both parties if the agreement is not adopted by stockholder consent within a short period—for example, twenty-four hours—after the agreement is signed.¹⁸ This approach was used in the acquisition of Fortegra Financial Corporation, a credit insurance and warranty provider, by Tiptree

16. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003).

17. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

18. *In re OPENLANE, Inc. S’holders Litig.*, C.A. No. 6849-VCN (Del. Ch. Sept. 30, 2011); *see also* *Optima Int’l of Miami, Inc. v. WCI Steel, Inc.*, C.A. No. 3833-VCL (Del. Ch. June 27, 2008) (Transcript).

Financial Inc., which was announced in August 2014. Interestingly, the merger agreement also included a go-shop clause, so that even after the controlling stockholders adopted the agreement, the target still had the right to terminate the agreement to accept a superior proposal during the thirty-day period after signing.

[C] Break-Up Fees

If the merger is not consummated because a bid is made for one of the merger partners by a third party and its board has exercised its “fiduciary out,” the merger agreement in a U.S. acquisition typically provides that the other party will receive a “termination” or “break-up” fee. The normal range is around 3%–4% of the transaction value (often equity value but sometimes based on enterprise value). In stock-for-stock deals, the parties may agree to somewhat higher termination fees than in all-cash deals. The percentage of the transaction value tends to be higher in smaller transactions. Note, however, that a court’s willingness to approve a given termination fee will depend in part on what other payments a terminating party might be required to make (for example, expense reimbursement obligations).

There can be considerable negotiation over what triggers the obligation to pay a break-up fee. A normal trigger would be the termination of the merger agreement by either party following a decision by the board of the covenanting party to withdraw its approval of the merger agreement, to recommend an alternate transaction with a third party or to enter into an agreement for an alternate transaction with a third party. Another common trigger is the termination of the merger agreement following a negative vote by the covenanting party’s stockholders if a proposal for an alternate transaction was pending at the time of the stockholder vote *and* an alternate transaction is consummated within some period after the vote.

[D] Stockholder Lock-Up Agreements

If one party has significant management or “inside” stockholders, the other party may request that they enter into “lock-up” agreements to support the transaction. In its simplest form, the lock-up agreement would require the stockholder to agree to vote for the proposed merger and not to transfer its shares between signing and closing. From the perspective of the stockholder and of the company whose shares are thus “locked up,” it is preferable if the voting agreement terminates upon termination of the merger agreement (including pursuant to the board’s exercise of its fiduciary out).

The stockholder may be asked to grant the other party an option on its shares at the merger price, which option becomes exercisable in the event of a competing bid. Alternately, the stockholder may agree to pay to that party some portion of the difference between the merger

price and the final price of any “topping” bid by a third party that is accepted by the board.

The merger partner who receives the benefit of a lock-up agreement may be deemed to be the beneficial owner of the stockholder's shares for the purposes of state business combination statutes. For this reason, and because target boards need generally to understand the scope and effect of deal protection devices in the transaction, it is customary for the target's board to approve such agreements before they are entered into by the stockholder and the other party. The decision whether to approve the stockholder agreement requires the board to consider fiduciary duty issues similar to those raised by the no-shop covenant. Unless the stockholder agreement terminates upon termination of the merger agreement (including pursuant to the exercise of the board's fiduciary out), the board's approval of a stockholder agreement in a case where the stockholder controls a significant or controlling block of shares may render any fiduciary out that the board may have obtained to its no-shop covenant ineffective to permit the board to accept a superior offer. In such a case, the board's approval of the stockholder agreement will effectively have “locked up” the deal. Further, if the merger agreement contains a covenant (as discussed above) requiring the board to submit the merger proposal to a stockholder vote even if the board determines, based on a subsequent superior offer, to recommend against approval, the existence of a stockholder voting agreement covering a significant percentage of shares may limit the impact that the board's adverse recommendation will have.

In considering from how many and which stockholders the acquiror should seek to obtain stockholder voting or option agreements, the SEC's registration requirements and gun-jumping and proxy solicitation rules come into play. An acquiror that casts its net too broadly—including non-traditional members, such as middle management, in the lock-up group—may find itself responding to SEC inquiries regarding whether it has solicited votes without filing preliminary proxy materials or has privately offered its securities in an unregistered offering.

[E] Stock Options

When mergers could be accounted for as poolings of interests, one or both of the merger partners sometimes would request that the other party grant it a stock option on up to 19.9% of that party's shares (the maximum percentage that can be issued by NYSE and Nasdaq companies without a shareholder vote) at the current market price. One reason was that the grant of the option could prevent a subsequent bidder from using pooling treatment. Since the demise of pooling accounting, however, lock-up options are rare.

[F] Other Contractual Protections

Targets, bidders and merger partners have continued to find new ways to create incentives for transactions to be completed as promptly as possible, to protect against interference from third parties and to ensure that companies remain committed to an agreement once it is signed. For example, the target may require the acquiror to pay a substantial fee (sometimes called a “reverse termination fee”) if the agreement is terminated because specified regulatory approvals are not obtained by a specified date. A target pressed into a tightly locked-up merger agreement may be able to compel the acquiror to waive the “material adverse effect” or “material adverse change” (MAC) closing condition or narrow the definition such that the acquiror will clearly have assumed the risk of adverse changes resulting from announcement of the transaction. Merger agreements sometimes have two-way break-up fees, in which the target is entitled to a break-up fee in the event the acquiror’s stockholders vote against the merger or the proposal to issue shares in the merger.

One possible threat to a deal is that the acquiror will get cold feet. As noted above in section 1:2.2, the acquiror’s obligation to close the transaction will typically be conditioned on the absence of any MAC affecting the target company. The Delaware courts have historically interpreted MAC clauses narrowly, restricting a buyer’s ability to walk away from a deal. But, in October 2018, the Delaware Court of Chancery for the first time allowed a buyer to terminate an agreement to acquire a publicly held company on the basis that the target had suffered a “material adverse effect.” In that case, *Akorn, Inc. v. Fresenius Kabi AG*,¹⁹ Fresenius Kabi AG, a German publicly listed healthcare company, had agreed to acquire Akorn, Inc., a Nasdaq-listed generic pharmaceutical company. Subsequently, Akorn’s results deteriorated significantly and Fresenius discovered “serious and pervasive data integrity problems.” Fresenius then sought to terminate the merger agreement, including on the grounds that (i) Akorn’s representations regarding regulatory compliance were incorrect to a degree that would reasonably be expected to result in a MAC and (ii) Akorn had suffered a MAC. Akorn sued, seeking a declaration that Fresenius’s attempted termination of the merger agreement was invalid and a decree of specific performance compelling Fresenius to close. The Court of Chancery, applying the standard set forth in *IBP, Inc. v. Tyson Foods, Inc.*,²⁰ held that the substantial year-over-year declines

19. *Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018).

20. *In re IBP, Inc. S’holders Litig.*, 789 A.2d 14 (Del. Ch. 2001).

in Akorn's revenues, operating income and earnings per share after signing were both "material when viewed from the longer-term perspective of a reasonable acquirer" and "durationally significant." Furthermore, the Court of Chancery determined that the breaches of Akorn's regulatory compliance representations were widespread and pervasive, and that the financial impact of these violations to Akorn was approximately \$900 million, representing about 20% of the equity value implied by the merger price. The court found that this change was "material when viewed from the longer-term perspective of a reasonable acquirer," and accordingly that the breach would reasonably be expected to result in a MAC. The Court of Chancery's decision was subsequently affirmed by the Delaware Supreme Court.²¹

Despite the *Akorn* ruling, a buyer must still clear a high bar to invoke a MAC condition. The Delaware cases continue to hold that:

- ***A MAC has to be material.*** The acquiror should not assume that it will be able to walk away from an acquisition because of a problem with the target's business unless the problem seriously impairs the long-term value of the business.
- ***Disclosure schedules are important.*** The target's representations are typically limited by exceptions disclosed in a disclosure schedule. The target will want to be sure that the exceptions are broad enough, and qualify all of the relevant representations. The acquiror's goals are just the opposite.

§ 1:6 Hostile Acquisitions

Unsolicited bids and proxy contests in the insurance industry have not been numerous. They are rarely successful. However, hostile bids no longer carry with them the stigma they once had. Indeed, one of the largest-ever acquisitions in the insurance industry, AIG's 2001 acquisition of American General Corporation, began when AIG delivered (and made public) an unsolicited "bear hug" proposal to American General.

In recent years, there has been significant hostile deal activity involving specialty insurers and reinsurers in Bermuda. In 2009, Validus Holdings, Ltd., a Bermuda reinsurance group, made an unsolicited bid for another Bermuda reinsurer, IPC Holdings Ltd., after IPC announced an agreement to combine with Max Capital Group Ltd. Before the IPC shareholders voted on the Max transaction, Validus launched an exchange offer for all of the outstanding shares of IPC, conditioned on

21. Akorn, Inc. v. Fresenius Kabi AG, No. 535-2018, 2018 WL 6427137 (Del. Dec. 7, 2018).

termination of the agreement with Max. Ultimately, the IPC shareholders rejected the Max transaction and approved an amalgamation agreement between IPC and Validus. In 2011, Transatlantic Holdings Inc. was the object of a prolonged bidding war after it agreed to be acquired by Allied World Assurance Company Holdings, AG; the subsequent announcement of a hostile exchange offer by Validus led to the termination of the agreement with Allied World and, after several other parties made offers for Transatlantic, the company was acquired by Alleghany Corporation. In spring 2014, Endurance Specialty Holdings Ltd. announced a hostile bid to acquire Bermuda-based Aspen Insurance Holdings Ltd., which was withdrawn after Aspen's stockholders rejected Endurance's proposals to overcome Aspen's takeover defenses. Most recently, the Bermuda reinsurer PartnerRe Ltd. agreed to be acquired by the Italian investment company EXOR SpA after EXOR made several unsolicited takeover offers. The first of these offers was announced in April 2015, after PartnerRe had announced a friendly stock-for-stock merger with Axis Capital Holdings Ltd. Proxy advisory firms subsequently recommended that PartnerRe shareholders vote against the Axis transaction, which led ultimately to the cancellation of the vote and termination of the agreement with Axis. The subsequent acquisition of PartnerRe by EXOR was announced in August 2015 and approved by PartnerRe shareholders in November 2015.

"Bear hugs" have also been used in the U.K. and given that hostile takeover offers are rare in the U.K. insurance sector, a "bear hug" will usually either result in a recommended offer being forthcoming or in the offeror retiring from the scene. The recommendation of the target's board is a valuable prize for an offeror, since it will speed up the offer process, will enable the offeror to obtain in due diligence confidential information that would otherwise not be available to a hostile bidder and will, by virtue of a potentially shortened timetable and greater chance of obtaining acceptances, act to impede competing bidders.

The provisions of the City Code severely limit the effectiveness of a "bear hug," however, in that:

- Stake building in the target may be difficult to keep secret if conducted over a period of time because notification will have to be given to the target once prescribed shareholding levels are reached.
- Any information given by the target to a would-be bidder that makes a bona fide takeover approach will have to be made available also to any other bona fide prospective bidder for the target, and hence there may be a more level playing field than applies in some jurisdictions outside the U.K.

- The ability of the target to be locked into a process leading up to a bid by means of the sanction of significant cost penalties payable to the would-be bidder in the event that a recommendation is not given is severely limited by the U.K. rules on the giving of financial assistance by the target and by the prohibition in the City Code on break-up fees and similar financial and other deal protection penalties being imposed on the target.²²
- Any shareholding of a would-be acquiror or those acting in concert with it of 10% or more in a target which is (or is the parent of) an authorized U.K. insurer will require prior permission from the PRA and/or the FCA (thus limiting the would-be bidder's room to maneuver and imposing time limitations).
- A bidder that acquires shares or rights over shares in the target which would take its holding to 30% or more of the voting rights in the target will normally be obliged by the City Code to make a mandatory offer for the whole of the target's shares.
- Once a potential bidder has been identified in public (and under the City Code there are requirements on targets to publicly announce potential bidders from whom approaches have been received), the bidder has twenty-eight days within which to announce a firm intention to make a bid for the target (such announcement effectively binding the bidder to follow through with the bid under the City Code) or to announce that it does not intend to make a bid, in which case it will be locked out for six months from making any announcement, or taking any steps, in either case relating to any possible offer for the target.

Hostile bids in the U.S. insurance industry have historically been rare. This reflects the difficulties faced in completing a hostile bid generally, as well as the reluctance, until the 1990s, of large companies to consider hostile bids as an acceptable acquisition strategy. Insurance companies, moreover, have significant defenses in their arsenal that are unavailable to most other companies.

Unsolicited bids (which become hostile through not being recommended by the board of the target) have also been rare in the U.K. insurance sector for a variety of reasons, including the expense of mounting a hostile bid and the fact that institutional shareholder pressure on the board of the target is likely to lead to any reasonable

22. *See supra* section 1:5.1.

offer being one that the target's board feels obliged to accept. The provisions of the City Code noted above also serve to increase the pressure on any would-be hostile bidder when seeking to launch a hostile offer for a U.K. insurer especially given that the U.K. restrictions on the target funding bidder's abort costs may leave bidder exposed financially. Further, as discussed in section 1:3.2[A], the consequences of failure for the hostile bidder are significant in that the City Code will "lock out" the unsuccessful bidder from making a further offer or acquiring shares in the target for a twelve-month period.

§ 1:6.1 Hostile Acquisitions in the United States

Regulatory and structural impediments to acquisitions of insurance companies make hostile acquisitions in this industry particularly rare. As discussed above, acquisitions of U.S. stock insurance companies face significant regulatory hurdles, including acquisition of control provisions in state insurance holding company statutes which generally require approval of the state insurance regulator in the insurance company's state of domicile before a bidder may acquire "control" of an insurer, usually deemed to happen when an acquiror holds proxies or controls 10% or more of the voting stock of the insurance company or of the holding company of the insurance company. Insurance regulators have tended to favor stability for the protection of policyholders.

The structure of non-stock insurance companies also presents a strong deterrent to an acquisition. Hostile acquisitions of mutual insurance companies have almost never been attempted, and have never been successful, because an acquisition would require a decision by the mutual's board to abandon mutuality and to implement a costly and time-consuming conversion from a mutual to a stock form.

However, the possibility of a bidder's acquiring a stock insurance company with an unsolicited bid or proxy contest, although difficult to effect, should not be written off entirely. Indeed, there have been at least three examples of large unsolicited bids (AIG/American General, Cendant/American Bankers—although later terminated—and Nationwide/Allied) that led to definitive acquisition agreements. As consolidation within the industry progresses, hostile bids may accelerate as a method of acquiring control. In addition, bidders may use the threat of a hostile bid to buttress their efforts to acquire an insurance company on a negotiated basis.

Planning such acquisitions involves an intricate interplay between conventional M&A considerations and the unique features of the insurance industry.

[A] Insurance Regulatory Impediments to an Acquisition

Under the insurance holding company acts of most states, prior approval of the insurance regulator of the target insurer's state of domicile (that is, the state where the insurer is organized) is required before any person seeks to acquire "control" of the insurer or an entity that controls the insurer (such as a public company holding an insurance company subsidiary). Prior state insurance regulatory approval is required whether control is sought by means of a tender offer, open market purchases, or in any other manner, including the purchase of either direct or indirect control.²³

The upshot of the prior approval requirement is that the completion of the tender offer must be conditioned on receipt of regulatory approval (as it was in the Validus exchange offer for Transatlantic). However, as a practical matter it would be extremely difficult to obtain regulatory approval, or even submit a complete application for approval, without the cooperation of target management and access to nonpublic financial information about the target's insurance subsidiaries. Therefore, the hostile tender offer is useful primarily as a bargaining tool—a means of making a credible commitment to a transaction and thereby convincing target shareholders to oust recalcitrant managers or (as in Validus/Transatlantic) to reject an agreement with another buyer that has already been signed.

Prior approval may even be needed to conduct a proxy contest. State insurance regulators, on occasion, have issued rulings on whether a proxy solicitation of the shareholders of a target insurance holding company would constitute an acquisition of control requiring prior approval.

In the 1990 effort of Torchmark Corporation to solicit proxies to elect five directors to the fifteen-member board of American General Corporation, the insurance regulators for the states of California, Hawaii, Missouri and Virginia accepted Torchmark's contention that the election of five Torchmark nominees would not shift control. However, the Delaware, Indiana, New York, Tennessee and Texas insurance regulators ruled that the power to vote 10% or more of American General's shares constituted the acquisition of control. As discussed below, the constitutionality of the Tennessee acquisition of control law underlying the Tennessee Commissioner's ruling was the subject of a successful challenge by Torchmark.

23. These prior-approval requirements, in the context of an agreed transaction, are discussed in detail in chapter 5.

In connection with General Electric Capital Corporation's solicitation of proxies to elect four of its nominees to the thirteen-member board of directors of Kemper Corporation in 1994, the Illinois Acting Director of Insurance advised, in a letter to counsel to General Electric, that he did not believe that the solicitation and exercise of the shareholders' proxies constituted an acquisition of control, in and of itself.

Acquirors that were accumulating shares on the open market or making unsolicited bids have in the past brought suit to challenge the constitutionality of state holding company acquisition-of-control laws as applied to federally regulated tender offers, on the ground that they are preempted by the Williams Act (the federal law governing tender offers) or constitute an unreasonable burden on interstate commerce. The results have been mixed.

Legal challenges to state acquisition-of-control laws were raised in connection with Hoylake Investment Limited's proposed acquisition of B.A.T. Industries plc in 1989 and in Torchmark's bid for American General in 1990. Hoylake suits against nine insurance regulators, and prior litigation brought by Alleghany Corp. in connection with its proposed acquisition of 20% of the stock of The St. Paul Companies in 1988, have resulted in conflicting lower court holdings. The constitutionality of state insurer takeover laws was addressed by a higher court for the first time in connection with the Torchmark bid. The U.S. District Court for the Middle District of Tennessee in the Torchmark case granted Torchmark's request for an injunction against the Tennessee Commissioner of Insurance and held that, in ordering Torchmark to cease and desist from proxy solicitation, the Commissioner (i) was not protected by the federal McCarran-Ferguson Act because the takeover law does not regulate "the business of insurance," (ii) was preempted by the federal Williams Act, and (iii) prevented the exercise of shareholders' rights under the Williams Act and, thus, constituted an impermissible burden on interstate commerce. American General appealed the District Court's ruling to the U.S. Court of Appeals for the Sixth Circuit, which denied a motion to stay the District Court's injunction.²⁴

[B] Other Impediments to an Acquisition

In addition to state insurance regulatory requirements, the acquiror will consider the effect of other state law provisions regulating takeovers, including:

24. *Liberty Nat'l Life Ins. Co. v. Huddleston*, No. 3:90-0368, slip op. (M.D. Tenn. May 1, 1990), *aff'd*, No. 90-5598, 1990 WL 10009101 (6th Cir. May 2, 1990).

- Business combination statutes, such as section 203 of the Delaware General Corporation Law, which bans mergers with a 15% or greater stockholder for three years, with certain exceptions, unless, before the threshold is crossed, the board of the target approves either the transaction or the transaction in which the acquiror became a 15% holder.
- Control share statutes, in which a person who acquires more than a specified percentage of stock does not receive voting rights unless the other stockholders approve the acquisition (although the target's charter should be reviewed to determine if it has "opted out" of the applicability of such statutes).
- Statutes that permit shareholder rights plans that discriminate against certain stockholders, such as section 14-2-624(c) of the Georgia Business Corporation Code, relied upon by the District Court in Atlanta in a July 1997 decision to uphold the continuing director provision of the shareholder rights plan Healthdyne used to resist Invacare's tender offer.²⁵
- Statutes that permit or require directors to consider the interests of other constituencies, including employees, customers, suppliers and the communities in which facilities are located, in reviewing a proposed acquisition of the target.

[C] Defensive Measures

Although the regulatory impediments described above are formidable, they are not a guaranteed defense to an unsolicited takeover attempt. Their principal benefit is that they deprive the acquiror of the advantage of speed and surprise in its attempted takeover; accordingly, the target has the ability to challenge the acquisition through the regulatory process in addition to drawing on defenses available to all targets. However, an insurance company cannot depend on a third party—the state insurance regulator—to withstand a takeover bid that can be shown to be beneficial to the target company and its policyholders and stockholders. Moreover, a regulator will be more concerned with whether a bid is prejudicial to policyholders than with the adequacy of the bid process to the target's stockholders. An insurance group that wishes to be ready for potential unsolicited bids or proxy contests should review its situation and the defenses it would have available if the board concludes that a bid should be rejected.

25. See *Invacare Corp. v. Healthdyne Techs.*, 968 F. Supp. 1578 (N.D. Ga. 1997).

[C][1] Structural Defenses

In addition to the regulatory defenses available to insurance companies, an insurance company or its publicly held parent will want to consider adopting one or more of the following structural defenses in its charter or bylaws in order to strengthen its defenses against an unsolicited bid:

- Maintaining a staggered board (that is, a board in which one-third of the directors are elected each year for a three-year term), so that an acquiror cannot obtain complete control of a board in a single election; also requiring notice periods for nominating board members, restricting removal of board members except for cause, and providing that only continuing directors can fill board vacancies.
- Restrictions on who can call special meetings of stockholders and on whether stockholders can act by written consent.
- Supermajority voting requirements for mergers.
- “Blank check preferred,” which can be issued by board action without a vote of stockholders to a white squire or in connection with a poison pill.
- Supermajority requirements for stockholder amendments of bylaws.
- Bylaw notice requirements, so that nominations of directors or other stockholder-initiated proposals must be notified to the company a specified period of time before the stockholder meeting.

Many of these are customary in non-insurance public companies, although a publicly held insurance group will want to analyze probable stockholder reaction if they are to be proposed at a stockholder meeting. For instance, it is typically not possible to obtain stockholder approval of a staggered board provision in the case of a public company with a large base of institutional share ownership.

[C][2] Shareholder Rights Plans (Poison Pills)

A shareholder rights plan is intended to discourage a bidder from acquiring more than a specified percentage of stock in a company, without the prior approval of the company’s directors, by causing dilution of a large stockholder’s interest in the company if it acquires more than the threshold percentage of shares (usually between 10% and 20%). Almost all rights plans have both “flip-over” and “flip-in” measures; that is, they give holders other than the acquiror the right to buy stock of the acquiring company or of the target at half-price if

someone acquires the trigger percentage of stock. The result would be a significant dilution of the acquiror's economic interest in the company. Consequently, in the past decade, a rights plan has been triggered on only a single occasion; usually, a hostile bidder attempts to have the rights redeemed by the directors of the target company before the rights would be triggered, by applying pressure on the target through public dissemination of a "bear hug" letter, by litigation in connection with its bid, or by a proxy contest to elect new directors who would redeem the rights.

A rights plan can be adopted by the board without stockholder approval, since it is considered a dividend of the rights to stockholders. Adoption of rights plans has generally been upheld in courts since the Delaware Supreme Court's 1985 decision in *Moran v. Household International, Inc.*,²⁶ although there have been limits on plans (such as "dead hand" or "no hand" rights plans) viewed as limiting directors' ability to fulfill their obligations under Delaware law. The board's decision whether to adopt the plan, or whether to redeem the rights at some future time, will, in Delaware, be evaluated under the *Unocal* test.

Rights plans are common defensive measures, although strongly disliked by many institutional stockholders. As a result, it has become substantially less common in recent years for companies to maintain rights plans in the absence of a specific threat. Many precatory resolutions have been passed seeking redemption of rights plans; in some cases, they have involved companies in financial distress or in other unusual situations. Some opponents of rights plans have put forward mandatory proposals to restrict or prohibit rights plans, such as proposed bylaw amendments.

Since the rights under a rights plan can be redeemed by the target board, an acquiror can overcome the rights plan by persuading target stockholders to replace the board. Therefore, a rights plan is most effective in conjunction with a staggered board (described in section 1:6.1[C][1] above): the acquiror would need two annual voting cycles to take control of the board and redeem the rights, which is longer than most acquirors are willing to wait. Endurance tried to overcome this obstacle in its bid for Aspen by having the Aspen shareholders vote on a proposal to expand Aspen's board from twelve to nineteen directors, resulting in a majority of board seats being filled at the 2015 annual meeting. (Under Bermuda law, new board seats would be filled by the stockholders, not the incumbent directors.) However, the Aspen stockholders voted down the Endurance proposal.

26. *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985).

[C][3] Board Duties in Considering a Takeover Bid

[C][3][a] Business Judgment Rule

Under Delaware law, most decisions by a board of directors will be reviewed in the context of the business judgment rule. State corporation statutes typically provide that the business of the company is to be “managed by or under the direction of the board of directors.” A corollary is that a court will not substitute its judgment for the business judgment of the directors, so long as the directors act consistently with their duties of care and loyalty.

If the matter being considered relates to a takeover defense, Delaware courts require that, in addition to showing that the board had fulfilled its duties of care and loyalty to stockholders, the board establish that the plan was “reasonable in relation to the threat posed.”²⁷ A two-step analysis is applied: the court will first determine whether the defenses are “coercive or preclusive,” and, if not, the court will then determine whether they fall within a “range of reasonableness.”²⁸ One of the key elements in assessing whether a defensive measure is preclusive is whether it prevents the ability of the target’s stockholders to act on the proposed acquisition—for example, to remove the existing directors and to replace them with directors who will seek to remove obstacles to the takeover.²⁹ If the adoption of the plan (or later amendment to add discriminatory provisions) is made during a contest for control, a Delaware court would apply greater scrutiny to the board’s decision.³⁰

[C][3][b] “Just Say No”?

In Delaware—since *Paramount Communications, Inc. v. Time Inc.*³¹—the general view is that a target’s board of directors has the legal ability to “just say no” to an unsolicited takeover proposal in proper circumstances. In *Paramount Communications Inc. v. QVC Network Inc.*,³² the Delaware Supreme Court noted that “where a potential sale of control by a corporation is not the consequence of a board’s action, [the court] has recognized the prerogative of a board of directors to resist a third party’s unsolicited proposal or offer,” provided the decision of the board is “informed.”³³ The circumstances of each particular

27. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).
 28. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995).
 29. See, e.g., Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).
 30. See, e.g., *In re Santa Fe Pac. Corp. S’holder Litig.*, 669 A.2d 59 (Del. 1995).
 31. *Paramount Commc’ns v. Time Inc.*, 571 A.2d 1140 (Del. 1989).
 32. *Paramount Commc’ns v. QVC Network Inc.*, 637 A.2d 34, 43 n.13 (Del. 1994).
 33. See also *Moore Corp. v. Wallace Comput. Servs., Inc.*, 907 F. Supp. 155 (D. Del. 1995) (District Court for the District of Delaware refused to require a target company to redeem its pill).

case will determine what other action, if any, is required to be taken by the board as a matter of fiduciary duty. In considering the offer, the Delaware courts suggest that directors may consider the “inadequacy of the bid, the nature and timing of the offer, questions of illegality, the impact on constituencies other than shareholders, the risk of non-consummation, and the basic stockholder interests at stake, including the past actions of the bidder in other takeover contests.”³⁴

In *Air Products and Chemicals, Inc. v. Airgas, Inc.*,³⁵ the Delaware Court of Chancery was asked to address the “just say no” defense in its purest form: to decide whether a target subject to an all-cash, fully financed tender offer with a non-coercive structure could keep in place its poison pill and thus prevent fully informed stockholders from deciding for themselves whether to sell their shares in the offer. Citing Delaware Supreme Court precedent, the court firmly upheld the Airgas board’s right to maintain the poison pill.

[C][4] Defensive Techniques

In addition to the regulatory and structural defenses outlined above, once the target’s board has decided that it is appropriate to resist the bid, defensive techniques may include the following:

- litigation on antitrust and other issues, and public relations and regulatory activities;
- issuing shares to employees or other allies, or buying in stock to increase the proportion of shares held by management and other friendly stockholders in order to hold a blocking position under supermajority provisions;
- corporate restructuring, including recapitalization or a sale or spin-off of key assets or businesses (for example, through reinsurance); and
- buying out the acquiror’s stock holdings in the target, although this must be reviewed to determine the applicability of the federal greenmail tax, as well as state corporation statutes (such as New York Business Corporation Law section 513(e), which requires shareholder approval for a purchase of more than 10% of shares from a shareholder at a premium).

Under federal tax law, a person who receives “greenmail” is subject to a 50% excise tax on the gain (or other income) realized.

34. *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1341–42 (Del. 1987).

35. *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011).

“Greenmail” is any amount a corporation (or any person acting in concert with such corporation, such as a white knight) pays to acquire stock in such corporation if (i) the stockholder held the stock for less than two years before agreeing to the transfer, (ii) at some time during the two years prior to the acquisition the stockholder made or threatened to make a public tender offer for the stock of the corporation, and (iii) the acquisition is pursuant to an offer that was not made on the same terms to all stockholders.³⁶

[C][5] Entering into a Transaction with a White Knight

Under *Paramount*, a strategic merger with a white knight, in which the consideration is stock rather than cash, does not trigger a duty to seek the best price reasonably available, if the transaction does not involve change of control—that is, if, after the transaction, control remains in a fluid aggregation of public stockholders. A merger involving the target with a white knight, however, may require a vote of the target’s stockholders (if the target is itself a party to the merger or the target is issuing shares representing 20% or more of its voting power, requiring stockholder approval under New York Stock Exchange and Nasdaq rules). If so, the feasibility of obtaining the requisite vote will need to be assessed, for instance, if the hostile bidder is offering a premium while the strategic merger does not.

If the target decides to seek a sale to an alternate suitor (or the hostile bidder itself) in a transaction resulting in a change of control of the target, it must, under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,³⁷ *Paramount Communications Inc. v. QVC Network Inc.*³⁸ and other Delaware court decisions, seek to obtain the best price reasonably available to stockholders. While one way to do this would be to run an auction for the company, Delaware law recognizes that there is “no single blueprint” that directors must follow.³⁹ Acceptable alternatives might include a less formal “market check” or entering into an agreement with a white knight that includes a “go-shop” provision or that otherwise does not unreasonably deter future bids.

[C][6] Mutual Insurance Companies

Many insurance companies are not stock companies, and thus do not share the vulnerabilities of public companies to a hostile bid.

36. U.S. Internal Revenue Code of 1986 § 280G (as amended).
 37. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).
 38. *Paramount Commc’ns Inc. v. QVC Network Inc.*, 637 A.2d 34 (Del. 1993).
 39. *Id.* at 44, citing *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1286–87 (Del. 1989).

Most non-stock insurance companies are mutual insurance companies, with voting rights held by policyholders of the insurer. An acquisition of a mutual insurance company by a stock company would require a demutualization of the target—that is, the conversion of the mutual insurance company to stock form. Demutualization requires adoption of a plan by the mutual insurer's board of directors. A demutualization is a lengthy process, involving several months (and often a year or two) of discussions with the domestic state insurance regulator, a public hearing and a vote of policyholders, before approval is obtained from policyholders and the regulator. Furthermore, some state demutualization laws, and the plans of demutualization approved by insurance commissioners, have contained prohibitions against anyone's acquiring beneficial ownership of 5% or more of the voting stock of the demutualized insurer either before or for five years after the demutualization, except with the prior approval of the insurance commissioner of its state of domicile. Such a provision gives a demutualized company five years to get established and running as a stock company before it becomes exposed to takeovers in the same manner as any other stock company. In December 1995, as Guarantee Mutual Life Insurance Company was nearing completion of its demutualization, American Mutual Life Insurance Company (since renamed AmerUs Life Insurance Company and later acquired by Aviva) attempted to acquire control of Guarantee by proposing to acquire stock in the demutualization. The attempt was resisted by Guarantee and was ultimately withdrawn.

§ 1:6.2 Hostile Acquisitions in the United Kingdom

As indicated above, it is unusual in the U.K. for a hostile offer to be made, particularly in the case of a target engaged in the insurance sector as any takeover offer will require prior approval by the PRA and/or the FCA and may also raise either U.K. or EU competition issues. Even from a due diligence perspective a potential acquiror would have to rely on publicly available information on the target which will necessarily have limitations.

[A] The City Code on Takeovers and Mergers

Perhaps most importantly, however, the provisions of the City Code may serve to restrict an acquiror's ability to build a stake in the target prior to announcing an offer and indeed during the course of an offer by imposing certain disclosure obligations (in general, interests of 1% or more must be publicly disclosed during an offer period). These are in addition to the disclosure requirements of the U.K. Listing Authority's Transparency Rules as regards any interest of 3% or more (which applies irrespective of whether any offer period has begun).

The City Code also heightens the risk for would-be bidders in that their interest in the target or any approach made by them to the target may be required to be made public under the City Code and may force the would-be bidder into a twenty-eight-day period within which it must either commit to making a bid or withdraw for six months.

The City Code may also affect the terms of an eventual offer regarding the minimum level and form of consideration. If purchases are made during the three months prior to the offer period, or during any period between the commencement of the offer period and the announcement of a firm intention to make an offer by the acquiror, then the offer must not be on less favorable terms. Speculation in the market prior to any announcement may in fact push up the price which in itself may further prevent stake building. Where 10% or more of any class of the target's voting shares has been acquired for cash during the offer period and the preceding twelve months, or any shares of any class of the target have been acquired for cash during the offer period, the offer for that class of shares must be in cash at not less than the highest price paid.

Any attempt to build a stake in a target subject to the City Code will be subject to a ceiling of 30% of the voting rights, since once an acquiror holds that amount of the target's shares it is obliged to make a mandatory offer in cash at no less than the highest price paid by the acquiror over the previous twelve months. Moreover, the City Code recognizes the concept of persons acting in concert in applying such thresholds, and so acquirors and their advisers must consider who might fall within the definitions at any given time.

[B] The Target's Defense

A target's defense of a hostile bid will be aided by its own internal housekeeping to ensure that it can be alerted to the existence of a potential predator at the earliest possible opportunity and be able to respond quickly and communicate effectively with its major shareholders. This preparation should include reminding the directors of their duties under the City Code and also their fiduciary duties, described above. The target's advisers usually prepare a memorandum (and provide related training) to the board covering these and other matters, such as the appointment of an independent committee of directors to consider any potential bid. It is also good practice to have prepared in advance a draft holding press announcement in response should an approach materialize. The swift release of such an announcement by the target will be required by the Panel and is particularly important given the application of the Market Abuse Regulation.

Monitoring the target's own share register on a regular basis may be no guarantee of an early warning, given that purchases in the market are restricted and therefore not as common for the reasons set out

above, although instructing the target's registrars to watch volumes can be of assistance. The target can also issue notices under section 793 of the Companies Act 2006 to establish the identity of underlying owners of any new, or existing, holdings held in nominee names. This tool has become increasingly useful for a target that suspects a hostile bid, as the use of nominee accounts has grown in recent years. Registrars can also be instructed to alert the target if there is a request for a copy of its shareholder register.

[C] Restrictions on Frustrating Action

U.S.-style poison pills are rarely adopted in the U.K. The City Code has rules against frustrating action, and any alteration to the target's share rights will require shareholder approval. Traditionally, U.K. institutional shareholders have not been supportive of such structures and the ability to entrench special rights may also be restricted under the Listing Rules. The general principle of the City Code provisions is that at no time after a bona fide offer has been communicated to the target's board, or after the board has reason to believe that an offer may be imminent, may action be taken by the board in relation to the affairs of the company, without the approval of shareholders, which could effectively result in any bona fide offer being frustrated or in shareholders being denied an opportunity to decide on its merits. This is widely defined to include, for example, business or asset disposals, contract renegotiations not in the ordinary course, share issues or the payment of a dividend outside the normal timetable.

