

An Investor Overview of Hostile Takeovers in the United States

A hostile takeover is a transaction in which an acquirer gains control of the target company by going directly to its shareholders without the consent of the target's board of directors.¹ It usually starts with a "tender offer" in which the acquirer offers to purchase a sufficient amount of the target company's stock from its shareholders to obtain control.² After acquiring a majority of the target's shares, the acquirer can vote for directors who are favorable towards the acquirer's offer.³ The new board will then cause the target company to do a cash-out merger to eliminate any remaining shareholders who did not tender their shares in response to the tender offer.⁴

In general, the following two regulatory schemes govern a hostile takeover process in the U.S.: (a) federal law and (b) the law of the state of incorporation for the target company. This article focuses on the timing and notice requirements under federal law and states' anti-takeover defenses.

Federal Regulation

The Williams Act (the Act) provides the federal regulatory framework for tender offers and proxy contests.⁵ The Act is primarily concerned with disclosure and timing issues.

1. **Tender Offers: Section 14d and Regulation 14D.** Section 14d of the Securities Exchange Act of 1934 (the Exchange Act) and Regulation 14D require a bidder to make specific disclosures to security holders and mandate certain procedural protections.
 1. **Tender Offer.** While the term "tender offer" has not been clearly defined in any statutory provision or rule, the courts generally have applied the following eight-factor test in determining whether a particular acquisition program constitutes a tender offer.⁶ However, it is not required to have all eight factors:⁷
 1. active and widespread solicitation of security holders;
 2. solicitation for a substantial percentage of the issuer's stock
 3. offer is at a premium over the current market price;

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4. terms are fixed as opposed to flexible;
5. offer is conditioned upon the tender of a fixed number of securities;
6. offer is open for a limited period of time;
7. offer pressures security holders to respond; and
8. public announcements of a purchasing program concerning the target company precede or accompany rapid accumulation of a large amount of target company's securities.

2. **Applicability.** Section 14d and Regulation 14D apply to all tender offers for Section 12 registered equity securities made by parties other than the target (or affiliates of the target), so long as upon consummation of the tender offer the bidder would beneficially own more than 5% of the class of securities subject to the offer.⁸ A bidder must include any shares it owns before the commencement of the tender offer in calculating the 5% amount.⁹ Section 14d and Regulation 14D do not apply to a tender offer by an issuer for its own securities. Such tender offers are subject to Rule 13e-4.¹⁰

3. **Filing and Disclosure Requirements.**

1. Under Rule 14d-3, a bidder may not make a tender offer unless it:
 1. files a Schedule TO with the SEC;¹¹
 2. delivers a copy of the Schedule TO to the target and any other bidders who filed a Schedule TO; and
 3. gives oral notice of certain information required by Rule 14d-6 and mails a copy of the Schedule TO to any exchange on which the target's securities are listed (e.g., NYSE) and the NASD if the securities are traded on NASDAQ.
2. Schedule 13D. Rule 13d-1 also requires any person or group of

persons acquiring beneficial ownership of more than 5% of a voting class of a company's Section 12 registered equity securities to file a Schedule 13D within ten days after the acquisition.¹²

3. Cash Tender Offers and Exempt Securities Offers. As soon as practicable on the date of commencement of a tender offer, the bidder must publish, send or give the disclosure required by Rule 14d-6 by complying with any of (a), (b) or (c) of the following:¹³
 1. Long-Form Publication. The bidder makes adequate publication in a newspaper or newspapers of long-form publication of the tender offer.
 2. Summary Publication. If the tender offer is not subject to Rule 13e-3, the bidder may publish a summary advertisement of the tender offer and promptly furnish the bidder's tender offer materials to any shareholder who requests them.
 3. Use of Stockholder Lists and Security Position Listings. Any bidder using stockholder lists and security position listings under Rule 14d-5 must also satisfy the long-form publication or summary publication requirements described above on or before the date of the bidder's request.¹⁴
4. Registered Securities Offers. A registration statement containing all of the required information including pricing information must be filed by the bidder, and a preliminary prospectus or a prospectus that meets the requirements of section 10(a) of the Securities Act of 1933 must be delivered to security holders.¹⁵
5. Rule 14d-9. This rule requires the management of a target company and other non-bidder groups or persons who make recommendations or solicitations with respect to an offer to file with the SEC and deliver to the bidder and target company shareholders a Schedule 14D-9.¹⁶

4. **Procedural Protections.** The procedural protections mandated in Section 14d and Regulation 14D include the following:

1. Shareholders have the right to withdraw tendered securities while the tender offer is open (but not during a subsequent offering period).¹⁷ Under Rule 14d-11, a bidder may elect to provide a subsequent offering period of at least three business days during which tender offers will be accepted if certain requirements are met.
2. All shareholders of the subject class of securities must be treated equally.¹⁸
3. If any person makes a tender offer for less than all of the outstanding equity securities of a class, and if a greater number of securities are deposited than such person is bound or willing to take up and pay for, such securities will be accepted on a pro rata basis.¹⁹

2. **Tender Offers: Section 14e and Regulation 14E.**

1. **Applicability.** Section 14e and Regulation 14E provide the basic procedural protections and anti-fraud provisions applicable to all tender offers, including mini-tender offers (tender offers that result in ownership of 5% or less of the outstanding shares) and tender offers under Regulation 14D and Rule 13e-4.²⁰ Section 14e and Regulation 14E apply to tender offers for any type of security (including debt).²¹ These provisions apply both to registered and unregistered securities (including securities issued by a private company), except exempt securities under the Exchange Act, such as municipal bonds.²²
2. **Timing.** Section 14e and Regulation 14E require that a tender offer be open for at least 20 business days,²³ that the offer remain open for 10 business days following a change in the offering price or the percentage of securities being sought,²⁴ and that the bidder promptly pay for or return securities when the tender offer expires.²⁵ Section 14e and Regulation 14E also require the target company to state its position about the offer within ten business days after the offer

begins.²⁶ The target company must (i) recommend acceptance or rejection of the bidder's offer, (ii) express no opinion or remain neutral toward the offer, or (iii) state that it is unable to take a position on the offer.²⁷

3. **Anti-Fraud Provisions.** Section 14e provides a cause of action for material misrepresentations and omissions made in connection with a tender offer. The following sections are some of the anti-fraud provisions:

1. Rule 14e-3(a)—If a bidder has taken a substantial step or steps to commence a tender offer, any person other than the bidder who has material, non-public information relating to such offer may not purchase or sell the tender offer securities unless within a reasonable time prior to any such purchase or sale, the information is publicly disclosed.
2. Rule 14e-3(d)—The bidder, the target and their affiliates may not communicate material, non-public information relating to the offer to any other person where it is reasonably foreseeable that the communication is likely to result in a violation of the antifraud provision, unless the communication is made in good faith.
3. Rule 14e-8—Bidders are prohibited from announcing a tender offer that has not been commenced, if such announcement was made (a) without the intention to commence the offer within a reasonable time and complete the offer; (b) with the intention of manipulating the price of the bidder or target's stock; or (c) without a reasonable belief that the person will have the means to purchase the securities sought.

3. **Proxy Contests.** Another strategy that may be used in a hostile takeover is a proxy contest. A proxy contest occurs when the acquirer attempts to convince shareholders to use their proxy votes to install new directors who are open to the takeover. This is typically done at an annual meeting or at a special meeting called for this purpose. Section 14a of the Act governs the timing and disclosure issues in connection with the contest.

1. **Advance Notice.** A shareholder soliciting proxies to vote for a particular proposal must present the proposal at the applicable shareholder meeting. Such proposal should be submitted according to the company's governing documents, such as bylaws or charters. Most public companies have advance notice provisions in their bylaws relating to shareholder nominations for directors and shareholder proposals. In general, advance notice must be submitted within 60 to 90 or 90 to 120 days before the anniversary of the preceding year's annual meeting. These provisions require the nominating shareholder to include information about itself, its nominees and its security holdings in its nomination notice.
2. **Solicitation Prior to Furnishing the Proxy Statement.** As a general rule, unless an exemption applies,²⁸ it is inappropriate to solicit proxies or consents without first furnishing a proxy statement to shareholders.²⁹ However, solicitation may be made if any written communication includes:
 1. the identity of the participants in the solicitation and a description of their direct or indirect interests, in the subject matter of the solicitation or a prominent legend indicating where security holders can find the information; and
 2. a prominent legend advising security holders to read the proxy statement when it is available because it contains important information, and explaining how investors can get the proxy statement and any other relevant documents for free from the SEC's website or the participant.³⁰ Furthermore, a definitive proxy statement must be sent or given to security holders before or at the same time as the forms of proxy are furnished to or requested from security holders.³¹ Any soliciting material published, sent or given to security holders in accordance with Rule 14a-12(a) must be filed with the SEC no later than the date the material is first published, sent or given to security holders.³²
3. **The Proxy Statement and Proxy Card/Form of Proxy.** In a proxy contest, each side must file its proxy statement and form of proxy in preliminary form with the SEC at least ten calendar days prior to the

date definitive copies of such material are first sent or given to security holders.³³ The proxy statement must contain the information specified in Schedule 14A.³⁴ Also, as a general rule, the form of proxy must list each separate matter intended to be acted upon, whether or not related to or conditioned on the approval of other matters, and whether proposed by the registrant or by security holders.³⁵

4. **Anti-Fraud Rules.** Rule 14a-9 prohibits making false and misleading statements of material facts in connection with any solicitation of proxies subject to Regulation 14A.

The Law of the Target Company's State of Incorporation: Anti-Takeover Defenses

In addition to the federal law discussed above, the law of the state of a target company's incorporation is also relevant in a hostile takeover process. As Delaware serves as the state of incorporation for more public companies than any other state, Delaware corporate law serves as the model for corporate law in the U.S. However, some states have adopted their own anti-takeover protection measures to provide companies with a greater protection against hostile acquirers.

These are some common state law takeover defenses.

1. **Poison Pills.** In a typical poison pill plan, shareholders receive rights to purchase additional stock at a favorable price that become exercisable upon the occurrence of a triggering event (usually the bidder's acquisition of 10% or 20% of the target company's stock.)³⁶ Once the bidder has passed the threshold percentage, the value of the target company's stock becomes diluted and it makes the company an unattractive takeover candidate.³⁷ Delaware law permits the adoption of a poison pill plan.³⁸ Poison pills delay a takeover process by stopping the acquirer from buying more shares and forcing the acquirer to negotiate with the target company's board. This way, the target company's board earns more time to consider the proposal, negotiate with the bidder and propose alternatives to shareholders. Poison pills can also become the subject of litigation while a takeover offer is pending. Accordingly, it is difficult to predict whether a poison pill will stop a takeover or how much delay in completing a transaction will result.

2. **State Anti-Takeover Statutes.** Most states have adopted statutes which serve to protect target companies from hostile takeovers. Some of the examples are as follows:
 1. **Fair-Price Statutes.** These statutes typically compel a bidder for the corporation's majority stock to pay at least the fair market price for the stock held by minority stockholders. This makes it more difficult and expensive for bidders to eliminate minority shareholders.
 2. **Control-Share Statutes.** Control-share statutes generally require shareholder approval before the acquirer of a control share of the stock is permitted to vote its control share. These statutes usually allow the acquirer to force the management to hold a special shareholder meeting within 50 days of the acquisition in order to hold such a vote.³⁹ Control-share statutes typically only help target companies resist takeover offers when they have no other defenses.
 3. **Business Combination Statutes.** These statutes typically place a three-year (or five-year) moratorium on business combinations between an interested shareholder (usually, a shareholder with 5% to 25% of the stock, depending on the state) and the target company. For example, the Delaware statutes impose a three-year moratorium at the 15% ownership level unless the transaction is approved by the board and a two-thirds vote of outstanding shares not owned by the acquirer or another exemption applies.⁴⁰ This business combination statute helps the board of the target company gain bargaining leverage with a potential acquirer, unless the business combination is overwhelmingly supported by shareholders.

Conclusion

Legal requirements that apply to a hostile takeover in the U.S. are complex and inextricably intertwined between federal law, state law, and company charter or bylaw provisions. These governing requirements affect the relative bargaining positions of boards, bidders and shareholders, and make the dynamics of each transaction different. Because of this complexity, the impact that they will have on specific situations can be difficult to predict.

¹ Jay W. Eisenhofer & Michael J. Barry, *Shareholder Activism Handbook* (2013) [hereinafter *Handbook*].

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ See 15 U.S.C. §§78m(d)-(e); see also 15 U.S.C. §§78n(d)-(f).

⁶ See *Wellman v. Dickinson*, 475 F.Supp. 783, 823-24 (S.D.N.Y. 1979); see also *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 950 (9th Cir. 1985). But see *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 56-57 (2d Cir. 1985) (stating that the purpose of Section 14d is to protect the ill-informed solicitee, and that the question of whether a solicitation constitutes a tender offer within the meaning of Section 14d should be considered in the light of the totality of circumstances). See also the SEC's explanation of tender offer (SEC's explanation) available at <https://www.sec.gov/answers/tender.htm>.

⁷ *Wellman* at 823-24; see also the SEC's interpretation (SEC Interpretation) available at https://www.sec.gov/rules/interp/34-43069.htm#P36_3809.

⁸ 17 C.F.R. § 240.14d-1; SEC Interpretation. For purposes of Sections 14d and 14e and Regulations 14D and 14E, the term "beneficial owner" has the same meaning as that set forth in Rule 13d-3; provided, however, that, except with respect to Rule 14d-3 and Rule 14d-9(d), the term will not include a person who does not have or share investment power or who is deemed to be a beneficial owner by virtue of 13d-3(d)(1). 17 C.F.R. § 240.14d-1(g)(1). Under Rule 13d-3, a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power and/or investment power. It also includes any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement or device with the purpose of effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of Section 13d or 13g. All securities of the same class beneficially owned by a person, regardless of the form such beneficial ownership takes, will be aggregated in calculating the number of shares beneficially owned by such person; provided, however, that a person will be considered to be a beneficial owner, if that person has the right to acquire beneficial ownership of such security, as defined in Rule 13d-3(a) within 60 days, including but not limited to, any right to acquire: (A) through the exercise of any option, warrant or right; (B) through the conversion of a security; (C) pursuant to the power to revoke a trust, discretionary account or similar arrangement; or (D) pursuant to the

automatic termination of a trust, discretionary account or similar arrangement. 17 C.F.R. § 240.13d-3. The Code of Federal Regulations is available at <http://www.ecfr.gov/cgibin/text-idx?SID=2eacbbbce55554c0cd8edf4d9bd1b282&node=17:4.0.1.1.1.2.86.200&rgn=div8>.

⁹ SEC interpretation.

¹⁰ See 17 C.F.R. § 240.13e-4.

¹¹ Schedule TO requires disclosure of the following information: (a) a summary term sheet with the terms of the transaction; (b) the target company's information; (c) the filer's information; (d) the terms of the transaction; (e) past contacts, transactions, negotiations and agreements between the bidder and the target company; (f) purpose of the transaction and plans or proposals of the bidder with respect to the target; (g) the source of the bidder's funds or other consideration for the purchase of the securities; (h) persons employed, retained or to be compensated by the bidder to make solicitations or recommendations in connection with the offer; (i) the financial statements of the bidder; (j) any additional information; (xi) exhibits; and (xii) information required by Schedule 13E-3 that is not included in the Schedule TO, if a Schedule TO is combined with Schedule 13E-3 (for going-private transactions). 17 C.F.R. § 240.14d-100.

¹² A Schedule 13D must be filed by a person or a group acquiring such shares with a purpose of changing or influencing control of the issuer. However, when such a person or a group holds such shares for mere investment purposes, not for the purpose of changing or influencing control of the issuer, a Schedule 13G must be filed instead. A Schedule 13D requires detailed disclosure, including information regarding the background of the investor, the purpose of acquiring the stock and arrangements with the issuer. 17 C.F.R. § 240.13d-2. It also requires prompt updates in the event of material changes. *Id.* Unlike Schedule 13D, a Schedule 13G requires only basic information and in most cases must only be updated periodically. *Id.*

¹³ 17 C.F.R. § 240.14d-6(d) lists the information required to be included in such publications.

¹⁴ 17 C.F.R. § 240.14d-4(a).

¹⁵ 17 C.F.R. § 240.14d-4(b).

¹⁶ 17 C.F.R. § 240.14d-9. The information required to be included in a Schedule 14D-9 is similar to the information for a Schedule TO.

¹⁷ See 17 C.F.R. § 240.14d-101.

¹⁸ 17 C.F.R. § 240.14d-7.

¹⁹ 17 C.F.R. § 240.14d-8.

²⁰ SEC Interpretation.

²¹ SEC Interpretation.

²² SEC Interpretation.

²³ 17 C.F.R. § 240.14e-1(a).

²⁴ 17 C.F.R. § 240.14e-1(b).

²⁵ C.F.R. § 240.14e-1(c).

²⁶ C.F.R. § 240.14e-2.

²⁷ Id. If a tender offer is not subject to Regulation 14D, however, the bidder is not required to send its offer to the target. Therefore, the target may not know about the tender offer. The target should take all steps to comply with its obligations under Regulation 14E within ten business days, or as soon as possible upon becoming aware of the offer. SEC Interpretation.

²⁸ Some of the exemptions include solicitations by certain persons not seeking proxy authority, and solicitations of ten or fewer shareholders. 17 C.F.R. § 240.14a-2(b)(2); 17 C.F.R. § 240.14a-2(b)(6).

²⁹ 17 C.F.R. § 240.14a-3.

³⁰ 17 C.F.R. § 240.14a-12(a).

³¹ 17 C.F.R. § 240.14a-12(a).

³² 17 C.F.R. § 240.14a-12 (b).

³³ 17 C.F.R. § 240.14a-6(a).

³⁴ Schedule 14A asks for information such as the participants in the contest, interests of the participants, and directors/executive officers. See 17 C.F.R. § 240.14a-101.

³⁵ 17 C.F.R. § 240.14a-4(b).

³⁶ Handbook.

³⁷ Handbook.

³⁸ Handbook.

³⁹ See North Carolina General Assembly §55-9A-03 as an example.

⁴⁰ Del. Code tit. 8, § 203(c). The rule can be found at <http://delcode.delaware.gov/title8/c001/sc06/>.

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