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THE INVESTMENT BANK'S CONFLICT OF INTEREST DURING HOSTILE TAKEOVERS: FOR THE TARGET OR THE BIDDER'S SAKE?

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to my parents' pride and smile
to my grandparents' desire
to the joy of my family
to me,
good luck.

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INTRODUCTION

Does the investment bank act for the target or the bidder's sake?
In the investment banking industry often occurs that the investment bank finds itself in a potential conflict of interest during hostile takeovers while it is acting as an advisor for its clients.
How can the banker not fall into a conflict of interest if it advises client A while, at the same time, assisting client B in the hostile takeover of client A? And how can the banker be neutral after information about client A has been obtained and could be used to the advantage of client B in the hostile takeover of client A?
To understand the role of the investment bank in advising its bidder and target clients, a deep description and analysis have been conducted throughout the different strategies adopted by both parties to negotiate a takeover deal.
The hostile bidder can structure preliminary takeover strategies to settle in advance its presence in the equity ownership of the target company and to publicly trigger the shareholders to tender their shares to consequently gain control over the company. Then, takeover strategies are engaged in directly reaching the target's shareholders with an offer of takeover providing a notable premium to the current market value of the target.
The target firm, on the other hand, can put into play several defensive strategies to prevent or deter the hostile takeover bid by the unwanted suitor. The techniques adopted involve amendments in the corporate charter, the dilution of the shares of the bidder into the target firm, the costly remuneration of the top management upon the termination of their contract due to the takeover, the counterattack in buying the acquirer's shares, the lawsuit for misconduct and the strategic acquisition from a friendly third party. These and other methods are all used to make exorbitantly expensive the takeover. Therefore, the bidder firm either gives up on the hostile acquisition or raises the stake with an even larger acquisition premium to win the battle.
The investment banks which operate alongside the parties in the deal, act in their best interests maximizing the value for their shareholders.

Servaes and Zenner (1996) demonstrated that the advisory services provided by the bankers to the acquiring company do not lead to higher returns for the shareholders compared to deals not advised. However, although several researchers by Golubov, Petmezas, & Travlos (2012) found that top-tier advisors help their clients to improve their acquisition performance, the reputation-quality mechanism remains inconclusive, and acquirers advised by top-tier advisors do not outperform those advised by non-top-tier advisors.

Moreover, the pursuance of a hostile takeover by the acquirer produces value creation for the shareholders in the long-run; despite those expectations, Möhlmann (2012) demonstrated that even if the hostile acquirer outperformed in a pre-takeover stage, the post-takeover brings negative profit returns, hence, shareholders' value for acquiring companies is destroyed by pursuing a hostile takeover. The reasons for the long-term shareholder value disruption lie in managerialism.

For the target firm, the investment bank is fundamental in its role of advisor for which it is asked to review the financial adequacy and fairness of the bid and to obtain details on the financial and monetary stability of the bidder. More important, it advises the executives on the most powerful defensive strategies to adopt to avoid a hostile takeover in the best interest of the company and to better maximize the target's shareholder value. Pearce & Robinson (2004) proved that when executives support a poison pill provision to repeal a hostile attack or encourage litigation to extend the negotiation period between the two companies, the defense is likely to boost shareholder wealth.

In its advising role, the investment bank should act in the interests of its clients. A potential conflict between the interests of the bidder and those of the target arose when the banker advises or advised in the past client A and assist client B in the hostile takeover of client A. Usually, investment banks converge in a syndicate to share capital and risk to afford big deals like hostile tender offers. Hence, an investment bank that advised client A in the past may now assist client B in the hostile takeover of client A and this is because the investment bank that has been hired by client B, was part of the syndicate which advised client A on its prior dealings. This is the case in which the

potential conflict of interest can rise. When this happens, the private information collected from one corporation to pursue its own interest might be then shared with the bidder client in carrying out a divergent deal against the target client. Although such overlapping relationships do not constitute a breach by the investment bank, it violates the law if the banker exploits the knowledge of sizeable undisclosed data about a company to advantage the opposite party in the deal. Thus, if the considerable and strategic information about client A, that are material to the takeover, is transmitted to client B, this could affect the acquisition premium client B is willing to pay for the takeover of client A. It follows that the public revelation of this important information may significantly affect the abnormal returns of the stock price of client A. Building a Chinese wall and/or including a written agreement on disclosure in merger contracts can be a possible way out of potential conflicts of interest.

Considering the agency theory in the relationship between the bankers and their clients; an agency problem might occur if the banker, the agent, which operates on behalf of the target or the bidder firm, the principal, seeks to gain from the deal by pursuing its own goals. McLaughlin (1990) said that the fees paid to bankers are typically a percentage of the total value of a deal, therefore, the investment bankers of both target and bidder benefit more from higher premiums. However, the bidder's goal of minimizing the premiums paid conflicts with its bankers' objective of maximizing fees, while for the target, the interest of maximizing the premium is in line with the banker's objective. The result is that the potential agency problem arises between the hostile bidder and its investment bank.

Analyzing, instead, the dual role advisory of the investment bank when it advises the target and, at the same time, finances the bidder for the takeover, the conflict of interest arises between the target and its banker because the latter's advice is skewed by the profit it may gain by financing the bidder.

The two case studies examined in the paper point out the consequences suffered by the investment bank for being in a potential conflict of interest between its bidder and target clients. The charge of transmission of private information of the target firm by the

investment banks at issue, Goldman Sachs and UBS advising respectively the hostile takeover of Mannesmann and Dana Corporation, to the hostile bidder, resulted to be groundless and did not affect the outcome of the deal. The lawsuits against them were dismissed by the court.

HOSTILE TAKEOVER BID

1.1 HOSTILE TAKEOVER DEFINITION

The takeover is the acquisition of a target company by an acquirer company. The acquirer is the one who makes the bid to purchase the target which is the firm the acquirer wishes to take control of.

Typically, a larger company seeks to take over a smaller one, and the final deal could result from a mutual decision between the two companies, a friendly takeover, or lead to a hostile takeover bid by the acquirer.

The reasons behind a takeover lie in the maximization of value for the shareholders, therefore the main objective of this process is the increase of a company's value, both bidder and target company, by raising activity and profits. The acquirer can exploit the target's advantages and opportunities to create new synergies, become more valuable and eliminate the competition in the market. When a takeover concerns companies producing similar goods or services, the transaction will bring an increase in market share, synergy effect and scale effect. Such a takeover is called *horizontal integration*. *Vertical integration*, instead, is when one company takes over its former, for example, taking over a distributor or supplier, which enables the company to take control over the whole production process.

A hostile takeover occurs when the acquirer makes an attractive bid to buy and take control over the target firm by going directly to the target's shareholders, bypassing its management or the board of directors. What characterizes this process is that the attacking company invests in acquiring the target in a short time at a high premium thanks to its large amount of financial resources. Inversely, a simple buyer could have gradually bought the company's shares at a market price without investing so much money.

Generally, hostile takeovers occur when the attacking firm senses that the target company is easy to take over because of some appearances in its capital structure, income stream, and market perception. << Hostile takeovers intensify especially when a situation of a company, which can be a target of a hostile takeover, is characterized by:

- *dispersion of shares*
- *dispersion of shares; domination of single, private shareholder*
- *dispersion of shares; poor management, which results in its inefficiency*
- *dispersion of shares; undervaluation of share price (which can be a result of bad management)*
- *dispersion of shares; low level of debt and/or high level of liquid assets* >>[1].

A hostile takeover starts with a formally or informally private approach by the buyer towards the board of directors of the target company through an offer letter, followed by a meeting to clarify terms. At this stage, the target's board evaluate the key terms and decide if to accept the deal. If the board's members accept, a due diligence[2] process will be carried out and the offer will be announced. If they don't, the acquirer firm can structure hostile takeover tactics to finalize the deal directly with the shareholders of the target firm.
There are different payment methods through which the acquirer can take over the target company. It refers to cash, stocks and/or other securities that the acquirer offers to the target's shareholders.

[1] (Puziak & Martyniuk, 2012)
[2] Due diligence is an investigation or audit of a potential investment which serves to confirm all material facts that may have a direct impact on a buyer's decision to merge or make a purchase.

These are:

- *all-cash transaction*
  In the all-cash transaction, the acquirer makes an offer to purchase all or a portion of the target's shares outstanding for cash. The bid results in the cash offer price per share multiplied by the number of shares outstanding.

- *stock-for-stock transaction*
  In the stock-for-stock transaction, the acquirer makes an offer to purchase all or a portion of the target's shares outstanding by swapping its own stock for that of the target company. This deal is used by the acquirer to cover the costs of the acquisition because there is no cash expenditure. The bid calculation is based on a fixed exchange ratio or a floating exchange ratio. The exchange ratio is calculated as the offer price per share divided by the acquirer's share price.

    - In a *fixed exchange ratio* deal, the offer price per share moves in line with the underlying share price of the acquirer. The amount of the acquirer's shares received is constant.

    - In a *floating exchange ratio* deal, the offer price per share is set and the number of shares exchanged fluctuates in accordance with the movement of the acquirer's share price.

- *cash & stock transaction*
  In cash & stock transaction the acquirer makes an offer to purchase all or a portion of the target's shares outstanding by using a combination of cash

and stocks. The cash portion is settled according to the cash deals while the stock portion is settled according to either a fixed or floating exchange ratio of the stock-for-stock transaction.

In 1980, a particular strategy of tender offer evolved. The *front-end loaded, two-tiered tender offer* emerged at that time as one of the most potent weapons in the takeover game. The tactic involves a single offer to acquire 100% control of a target firm in two steps. In the first step, the unwanted bidder makes a cash offer to acquire a certain initial amount of the target's shares that produce control. In the second step, the acquirer buys the remaining shares by exchanging its own shares with those of the target company according to the stock-for-stock deal. The bidder's exchanged securities are worth less than the cash paid in the first step.
The two-tiered tender offer << is an extremely strong and attractive acquisition technique for two reasons. First, it increases the offeror's prospects for success because it prompts many target company shareholders to tender their stock quickly, before expiration of the first-step cash offer, and before the target can consolidate its defenses. Second, the two-tiered offer for 100% control is less expensive than a partial tender offer for control (with no mention of a second step) with the acquiror later deciding to acquire the remainder of the outstanding shares >>[3].
Although it is a powerful tool and creates value for the bidders, represents a sort of coercive measure for the target shareholders. Indeed, the two-tiered offer forces the unwilling target shareholder to tender their shares in the first step, otherwise, their stocks are acquired by the bidder at a lower price in the second step. This effectively prevents other potential offerors from bidding for the target.

[3] (Editors, 1982)

1.2 HOSTILE TAKEOVER TACTICS

The hostile takeover tactics are performed by the acquirer company to push for an attempted acquisition of the target company against the board's wishes.
The hostile takeover tactics could be divided into two categories depending on the time they are implemented. These are:

- *preliminary takeover steps (1.2.1)*
- *takeover strategies (1.2.2)*

1.2.1 PRELIMINARY TAKEOVER STEPS

a. Establishing a toehold position

This preliminary strategy is pursued by the potential acquirer before using the takeover tactics and deals with the initial accumulation of the target's share, purchasing them in the open market. In this way, the acquirer is trying to establish a toehold from which to launch its hostile bid.
By accumulating the target's shares, the bidder can make a lower final offer to buy the company since it might be able to avoid the payment of the acquisition premium[4]. The reason behind this is the unknowledge of the market about the bidder's accumulation of shares. If other investors get to know that there is a buyer who is seeking to acquire a company, they could be interested in buying the target company too. The competition between different bidders makes the target more valuable and the final acquirer will be the one who offers the higher premium.

[4] An acquisition premium represents the difference between the estimated real value of a target company four weeks before the acquisition announcement and the actual price paid to acquire it and represents the increased cost of buying a target company during mergers and acquisitions (M&A) transactions.

Another advantage of establishing a toehold is becoming one of the target's minority shareholders together with remaining the hostile bidder. This establishes a fiduciary duty that the target's board of directors has towards its shareholders, therefore it must also act in the interest of the hostile bidder. Moreover, the target's defence strategies related to acquisitions of shares are no longer applicable against the hostile bidder.

The downside of establishing a toehold is the potential costs the bidder might occur if, after the initial purchase of the target's shares, the bid fails due to target resistance, especially if bids are large.

b. Bear hug

The potential acquirer can put pressure on the management or the board of directors of the target company, before launching a tender offer, through the bear hug. This pressure deals with making a public statement expressing the interest in acquiring the target company for a much higher price than what the target is worth. This informal offer is directly exhibited to the shareholders and pressures the reluctant target company board to accept the bid in the best interests of its stock owners.

The offer is designed to appeal to the target's shareholders because the meaningful premium to the market value of the company makes it difficult for the target's board to refuse. Furthermore, the board risks lawsuits in case of refusal, as it is in contrast with its fiduciary duty.

Due to its high cost, the potential acquirer uses the bear hug when the overtures are not favorably received by the target's board, making it necessary for the bidder to go directly to the shareholders.

The bear hug needs to be followed by a tender offer for the target's shares outstanding otherwise there won't be a guarantee that the offer overcomes the board's resistance and that the potential acquirer will purchase the company at the stated price.

1.2.2 TAKEOVER STRATEGIES

a. **Tender offer**

The hostile tender offer is the bid to purchase the target's shares by the acquirer directly reaching the target's shareholders, going around its management and board of directors. It is a public solicitation to the target's shareholders to tender their stocks at a notable premium to the current market value within a certain time. At this stage, the bidder must obtain a sufficient number of shares to constitute a controlling equity interest in the publicly traded target firm. Ordinarily, this means the acquirer will own more than 50.0% of the voting stock. If the acquirer is not able to buy the number of shares he needs to have control over the target, the bid is cancelled.

The tender offer allows for the minority shareholders' approval of the proposal. In a traditional merger, instead, minorities must agree to the terms of the agreement negotiated by the board once the majority shareholders approve the proposal, to prevent the interruption of the merger before the premium is paid.

The tender offer can occur because the acquirer places a high value on the targeted business or when the target company's stock has fallen on hard times. Therefore, shareholders can benefit from the high acquisition premium ending up in a rich exit position. Indeed, << although targets boards often discourage unwanted bids initially, they are more likely to relent when a hostile tender offer is initiated >>[5].

[5] (DePamphilis, Mergers and Acquisitions Basics: All You Need To Know, 2010)

b. **Proxy fight**

The proxy fight, or proxy contest, is a strategy established by the bidder when it is already a shareholder of the target company. This takeover tactic deals with persuading the existing shareholders to vote out the management or the board members opposing the takeover to replace them with new board members who favorably accept the change in the ownership and therefore will vote in favor of the takeover.

Through a call of the special shareholders' meeting, the bidder may propose to replace the management or the board at a regularly scheduled shareholders' meeting. Before the meeting, the bidder may open an aggressive public relations campaign with direct solicitations sent to shareholders.

Shareholders will join forces attempting to gather enough proxy votes from the existing shareholders to replace the board members with candidates more willing to implement the bidder's proposed changes.

<< Initiating a proxy contest to replace a board is costly, which explains why there are so few contested board elections. For the official slate of directors nominated by the board, campaigns can be paid out of corporate funds, but shareholders promoting their own slate of candidates must pay substantial fees to hire proxy solicitors, investment bankers, and attorneys. Nonetheless, a successful proxy fight is a far less expensive way to gain control over a target than a tender offer, which may require purchasing a controlling interest in the target at a substantial premium >>[6].

[6] (DePamphilis, Mergers and Acquisitions Basics: All You Need To Know, 2010)

1.3 ROLE OF THE INVESTMENT BANK IN HOSTILE TAKEOVER ATTEMPT AND ACQUIRER'S SHAREHOLDERS' VALUE MAXIMIZATION

The investment banks, in Mergers and Acquisitions (M&A) transactions, constitute a bridge between their clients and the parties interested in the deal. Their role is to be intermediaries who advise their clients about the financial challenges they can face entering a deal. Considering a hostile takeover, the task carried out by the investment bank is concerned with evaluating how much the target company is worth and structuring the deal in a way that is favorable to the bidder.

The investment banks are hired by acquiring firms and therefore by the hostile bidders, when the acquisition is more complex, when they have less prior acquisition experience, when the target operates in many different industries, and when they have lower insider ownership[7].

The acquirer company shareholders' value maximization depends on several factors, among which, whether to hire an investment bank which serves as a financial advisor. Servaes and Zenner (1996) demonstrated that acquirer returns, surrounding the announcement of the takeover, do not differ across in-house deals, where the bidding firm does not retain an investment bank for the transaction and deals advised by investment banks.

The type of investment bank the bidder leans on for the transaction may lead to higher or lower returns; bidding firms gain more when employing top-tier advisors, the so-called Bulge Bracket Banks, rather than non-top-tier advisors, but only in public acquisitions and these high-quality services comes at a premium price in terms of advisory fees[8].

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[7] (Servaes & Zenner, 1996)

[8] (Golubov, Petmezas, & Travlos, 2012)

<< However, the empirical evidence on this reputation–quality mechanism remains inconclusive. Some studies find that acquirers advised by top-tier advisors do not outperform those advised by non-top-tier advisors and may even obtain negative abnormal returns[9] (e.g., Hunter and Jagtiani, 2003; Ismail, 2010; Michel et al., 1991; Rau, 2000; Servaes and Zenner, 1996) >>[10].

In contrast, several researchers support the thesis on the best-quality services that lead to a high acquirer's performance. The quality of the services is related to the superior ability of top-tier advisors to identify synergistic targets to assure a larger portion of synergies for the bidder. Therefore, the top-tier advisors help their clients to improve their acquisition performance.

Going back to the definition of a hostile takeover attempt, it's straightforward that it is an unwanted deal that comes from a separation of ownership and control in public companies; management may consider rejecting the offer while the shareholders are willing to accept it. If the target company decides to implement anti-takeover defences to discourage the takeover by the bidder, it will become much more difficult and costly for the acquirer to close the deal.

The result could be a substantial premium to be paid to the market value of the target company to appeal to the management and the shareholders of the target. Therefore, it's important to understand whether the pursuance of a hostile takeover creates value for the acquirer's shareholders. Even though this target's opposition goes at cost of the return of the bidder's shareholders, hostile takeovers have proven to still being pursued[11].

[9] Abnormal returns are defined as the excess return of a stock compared with the expected return over a specified period generally starting 10 days before the first announcement of the takeover and ending at the resolution date or the delisting date, whichever occurs first.

[10] (Guo, Li, Wang, & Xing, 2015)

[11] (Möhlmann, 2012)

A deeper analysis has been conducted to obtain the reason behind the pursuance of the hostile takeover by the bidder. What is expected is the poor performance of the target before the takeover and the outperformance of the acquirer in the period after the takeover. The evidence found in the recent past by a few researchers, comparing the pre- and post-takeover performance, return that the hostile takeovers were expected to create value in the long run.

Despite those expectations, the abnormal returns calculated and reported by Möhlmann (2012) show that there is no proof suggesting pre-takeover underperformance of hostile targets. Additionally, while it has been proved a pre-takeover outperformance by the hostile acquirer, with regard to the post-takeover performance in the long-term, the results are consistently negative and statistically significant in terms of profit returns. Therefore, the evidence demonstrates that shareholders' value for acquiring companies is destroyed by pursuing a hostile takeover.

The long-term shareholders' value disruption could be led back to managerialism. Managers might have overestimated the value and the synergies related to the acquisition of the target firm by paying a too high control premium. This is the case of *Management hubris*. << Hubris on the part of individual decision-makers in bidding firms can explain why bids are made even when a valuation above the current market price represents a positive valuation error. Bidding firms infected by hubris simply pay too much for their targets >>[12].

Another explanation behind managerialism is the so-called *Empire building*. It is the managers' action of attempting to raise their wealth and personal status by buying control over large firms instead of optimally allocating resources and maximizing profit, therefore building their empire.

[12] (Roll, 1986)

The third rationale behind managerialism deals with the commonly named *Eat or be eaten* theory. << Managers can reduce their chance of being acquired by acquiring another firm and hence increasing the size of their own firm >>[13].

However, more recent academic research has shed a light on the long-term shareholders' value disruption by acquiring companies. It has demonstrated that there is a long-term value creation when a mixed payment[14] takeover takes place and are recorded positive abnormal returns in the long run when same-industry hostile deals occur[15].

[13] (Gorton, Kahl, & Rosen, 2005)

[14] The mixed payment is a form of payment in which an acquirer uses a combination of cash and stock payment to purchase the target company.

[15] (Wennekers, 2021)

HOSTILE TAKEOVER DEFENSIVE STRATEGY

2.1 HOSTILE TAKEOVER DEFENSE DEFINITION

The hostile takeover defense is the response of the target company to the hostile takeover bid by the acquirer. Devising these techniques, the target can make the takeover much more difficult and costly for the acquirer who needs to raise the stakes to win the battle. The attacked company takes up defensive activity to circumvent the hostile takeover by convincing current shareholders not to sell their shares.

These plans of defense are direct at reducing the value that the bidder can find in the firm. The value-enhancing characteristics of a target are:

- *High and steady cash flows*
- *Low debt levels*
- *Low stock price relative to the value of the firm's assets*

These factors may make a firm vulnerable to a takeover.

Concerning strategies to avoid being targeted by a hostile bidder, the target company should undertake several preventive actions; these are:

- *Peer and sector review*

  The target company should monitor its financial performance to find any signs of financial weakness by comparing the results to the ones of its peers. If a weak spot is observed, it should immediately rectify its financial performance.

- *Review of investor base and trends*

  The target company should always keep an eye on its investor base, maintaining a proactive and constant dialogue with them, and on its

actively trading volume[16] and ownership trends. It should also keep credit rating agencies informed about its creditworthiness and build up a supportive shareholders base.

- *Capital structure and distribution review*

  The target company needs to have a stable capital structure, optimizing its cost of capital.

- *Portfolio optimization*

  The target company should manage properly its portfolio of business and activities by regularly evaluating and optimizing it. It should also monetize low-growth assets[17] and enhance the value of high-growth assets.

- *Review takeover defenses*

  The target company should review its Business Plan, operating performance and competitive positioning and have an up-to-date structural defense available.

- *Ensure supervisory board/non-executive support*

  The target company's management should always rely on the support of its supervisory/non-executive board that is involved in the company's affairs.

[16] Trading volume is the total number of shares of a security that were traded during a given period of time.
[17] Growth assets are generally assets that aim for capital growth. These types of assets can often have the potential for higher investment returns over the longer term, but they also tend to have higher investment risk and likelihood of their value rising and falling, either a little or a lot, in the short term.

2.2 HOSTILE TAKEOVER DEFENSE TACTICS

Hostile takeover defenses are impediments to potential bidders and are designed either to slow down an unwanted offer, giving the target firm the chance to strengthen its existing defense or put new ones in place, or to force a suitor to raise the bid to get the target's board to rescind the defense.

Methods of resistance against a hostile takeover are divided into two groups:

- *Pre-offer defense (2.2.1)*
- *Post-offer defense (2.2.2)*

2.2.1 PRE-OFFER DEFENSE

The pre-offer defense tactics are preventative anti-takeover measures; in other words, they are techniques that the target company brings into play to prevent << a sudden, unexpected hostile bid from gaining control of the company before management has time to assess their option properly. If the pre-offer defenses succeed in delaying the change in control, the target firm has time to erect additional defenses after the unsolicited offer is received >>[18].

a. **Anti-takeover corporate charter amendments**

i. ***Staggered board***

A staggered board election involves grouping the firm's directors into classes, typically three, and each year only one of the groups or one-third of the directors, is elected in following annual meetings.

[18] (DePamphilis, Mergers and Acquisitions Basics: All You Need To Know, 2010)

<< For example, a board with twelve directors might be grouped into three classes, with four directors standing at the 2001 annual meeting, four more directors standing for reelection in 2002, and the remaining four directors standing for reelection in 2003. With three classes, directors in each class would be elected to three-year terms >>[19].

Since the hostile acquirer is looking to replace the board of directors of the target company, it won't be able to do it in a short time, even if it owns a majority of the common stock. It would take more time to reach the majority in the board of directors because only a few members each term can be replaced. Without groups in the board, the hostile bidder would have taken just one year on the next annual general meeting, to replace enough members to gain the majority. Therefore, the classes will prevent immediate taking control of a company slowing down the hostile takeover process and giving the management the time to enhance its defensive techniques or to set new ones. << By preventing a majority holder from obtaining control of the board for two years, this defense hinders the bidder's ability to make significant changes in the corporation immediately. This limitation may in turn reduce the bidder's willingness to bid, and may increase the bidder's difficulty in getting financing >>[20].

[19] (Bebchuk, Coates, & Subramanian, 2002)
[20] (Ruback, 1987)

ii. ***Supermajority***

A supermajority is a company's corporate charter amendment[21] which requires a qualified majority vote to approve important decisions for the company itself. It entails a majority vote over 50.0%, usually 80.0%.

Hostile takeover bidders require higher percentages of shares to obtain control over the target firm when the firm has a supermajority amendment. It is considered a << mild takeover defense. Bidders can respond to this amendment by simply tendering for the whole firm >>[22].

iii. ***Fair price***

The fair price amendment is a provision in the target's constituent documents according to which the takeover of a company must occur at least at a fair price. The fair market price is frequently based on the company's historical stock prices. It deters the bidder from offering varied prices for stocks at different stages of the acquisition and protects the minority shareholders who own a small percentage of the target's equity. This discourages hostile takeovers by making the acquisition more expensive since the bidder has to pay all stockholders the same price. If it does not, it is imposed a supermajority requirement.

In other words, fair price amendments are designed to prevent two-tier takeover offers. Under a two-tier tender offer, the unwanted bidder makes, in the first-tier, an attractive cash offer to acquire control over the target and then, in the second-tier, substantially lowers the price, compared to the first-tier offer, to buy the remaining share outstanding. This provides an incentive for the target shareholders to tender to receive the higher price.

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[21] An amendment is a change or addition to the terms of the firm's bylaw.

[22] (Ruback, 1987)

<< Since most stockholders tender, and since the bidder accepts shares on a pro rata basis, most shareholders get a weighted average of the first and second tier offer prices, or the blended price >>[23].

iv. ***Dual Class Recapitalizations***

The dual class recapitalizations are plans intended to restructure the equity of the target company into two classes with different voting rights. The superior voting stock, typically distributed to the target's shareholders, has lower dividends or reduced marketability; for this reason, the shareholders can choose to exchange the superior voting rights share for ordinary common stock. The managers of the target company who hold inferior voting stock, cannot participate in the exchange. Therefore, the voting power of the target firm may be completely overturned. Even if managers have relatively small equity holdings, they can control a majority of the votes and have the veto rights over control changes, after the recapitalization.

As a result, the dual class recapitalizations prevent bidders from obtaining control by tendering for the shareholders' shares because the majority of voting rights is in the hand of the incumbent management. Even if the unwanted bidder acquires the portion of the shareholders' equity interest, it would not be able to reach the sufficient number of votes to replace the incumbent managers or to acquire control over the target.

[23] (Ruback, 1987)

b. **Poison Pill**

Poison Pill, or shareholder rights plan, is one of the most powerful defenses against hostile takeovers. The word poison pill comes from the time of wars and espionage when spies swallowed those pills to avoid being detected. This is exactly what happens to the target company. To prevent being taken over, the target’s management structures a poison pill strategy by distributing to the target’s shareholders the right to purchase shares of the target at a considerably reduced price. If exercised, these rights can substantially dilute the acquirer’s shareholding in the target company, in the case of a change in ownership, and thus discourage the takeover. In other words, as more shares are issued, the poison pill dilutes the voting rights of the current target’s shares and the potential acquirer would need to purchase more shares to reach the majority to gain control over the company. This would lead to the company being less appealing and place the existing shareholders in a stronger position, making the takeover harder and more costly.

The shareholder rights are inactive until they are triggered. << A triggering event occurs when a tender offer is made for a large fraction of the firm, usually 30 percent >>[24]. In the end, the poison pill can only be disarmed by the vote of a majority of the board of directors of the target company.

[24] (Ruback, 1987)

Poison pill can be carried out by structuring three different types of pills:

- *Flip-in poison pill.*

  The Flip-in poison pill allows existing shareholders to purchase additional target shares at a discount. The price, instead, at which the target's shares are sold to potential acquirers is the market price without a markdown. The discount is often significant, enabling the existing shareholders to hold, together with their current stake, the equity interest in the part of the company still not acquired. The right to purchase the target's shares occurs only before a potential takeover and it is usually triggered when the hostile bidder reaches a certain threshold of the percentage of ownership of the target.

  Flooding the market with new shares dilutes the equity of the acquirer, lowering the value he gained for the price paid. The dilution of the current value of the shares already purchased by the bidder wards off the possibility it had to cross the ownership threshold, deterring the hostile takeover.

  The provision for a flip-in poison pill takeover defense can be employed if it appears in the target's firm's bylaw or charter prior to the takeover.

  The downside of establishing this strategy deals with the possible dilution of the shareholders' power and the stock value making the company less attractive and pushing potential investors to turn away.

  Moreover, sometimes happens that the unwanted acquirer tries to fight a flip-in poison pill in court to dissolve the deep discount plan, winning the case.

  Flip-in plans often contain flip-over provisions. The flip-over provisions give the existing target's shareholders the right to purchase the acquiring

company’s stock at a discounted price. These rights could be exercised if the takeover ends successfully, and the result will be a dilution of the acquirer’s ownership structure. The share purchased by the target’s shareholder embodies the right to buy the acquiring firm at the market price.

- *Dead Hand poison pill*

  The Dead Hand poison pill is a strategy that allows the automatic issuance of new shares by the target company to all the other shareholders if the unwanted bidder has purchased a certain number of shares, seeking to buy the company. The dead hand provision kicks in once the unwanted bidder acquires typically between 15% to 20% of the target company’s shares and leads to the aspiring hostile bidder’s stock holdings or percentage of ownership in the target becoming massively diluted. This will make the hostile takeover prohibitively expensive.

  The strong aspect of the Dead Hand is that it can’t be overcome by the hostile bidder. While a regular poison pill can be defeated by launching a proxy contest and then electing new members of the board of directors to redeem it, the Dead Hand cannot be won with a proxy contest. The provision allows only the directors who adopted it to rescind it once an acquirer threatens to acquire the target; if the board members are replaced under a proxy fight, they cannot rescind the provision. This means that existing directors can prevent the acceptance of an unsolicited offer, regardless of the shareholder’s wishes or the opinions of the newly elected directors.

Although earlier court decisions restricted the use of the Dead Hand and the No Hand due to too much power in the hands of the board of directors, the more recent rulings have upheld the use of such pills.

- *No hand (slow hand) poison pill.*

  No Hand provision prohibits the redemption of the pill within a certain period of time. In other words, it prevents any members of a newly elected board from redeeming the rights to authorize a takeover, if the majority of the new board is nominated or supported by the hostile bidder.

c. **Poison Put**

Poison put is a type o poison pill provision in which the executives of the target company issue bonds, with a poison put covenant. The poison put covenant gives bondholders the right, but not the obligation, to redeem their bonds in case of an acquisition. In other words, it gives them << a put option requiring the issuer to offer to purchase all the bonds, typically at 101.0% of par, when changes in control occur >>[25]. As a result, if the takeover occurs, the new owner will be forced to instantaneously repay the outstanding debt if the bondholders exercise their right of early repayment before the bond's maturity date. This strategy represents an added acquisition cost that the bidder must pay if it wants to take over the target firm; it increases the sum to be paid by the debt to be repaid in case of a change in control. In contrast to the poison pill, the poison put does not affect the number of target's shares in the market, the price of the shares or the

[25] (Bereskin & Bowers, 2015)

shareholders' voting rights. It simply raises future bond obligations to the unwanted bidder if the acquisition occurs. Therefore, it impacts the amount of cash the acquiring company must have to cover the immediate repayment of bonds.

In conclusion, this strategy prevents a hostile takeover by making it more expensive to gain control over the target firm.

d. **Golden Parachute**

The Golden Parachute is a safety net for the top executives of the target company when a change in control occurs. It is an employment contract that guarantees additional remuneration to the top management in case of termination of its employment following a successful hostile takeover acquisition. The expensive packages of benefits may include the base salary, cash bonuses, generous severance pay, pension benefit and fringe benefits such as stock options, medical insurance, life insurance and stock buy-back plans.

<< Executives may collect payments when their responsibilities are altered, salaries are lowered, or jobs are lost due to changes in control. Executives need to be terminated to trigger benefit payments under the golden parachute >>[26]. Since the compensations decrease the target's assets, the amount the acquirer is willing to pay for the target's shares is reduced as well. A lower bid will harm the target shareholders and the unwanted buyer will be forced to raise the stakes to attract them. It turns out to be really expensive for the bidder, therefore, this defense effectively deters the hostile takeover.

[26] (Machlin, Choe, & Miles, 1993)

The golden parachutes << have created controversy in regulatory agencies, in the popular press, and among shareholders and management alike. Opponents assert that golden parachutes are deleterious to shareholder interests, increasing the cost of acquisition by inappropriately diverting wealth to undeserving managers, while proponents claim they enhance shareholder wealth, reducing the principal-agent conflict between shareholders and managers and thus facilitating a successful takeover >>[27]. In other words, on the one hand, the golden parachute makes it easier to hire and retain top executives and enhances their objectiveness in the negotiation of the deal and their fiduciary responsibility to act in the best interest of the company. On the other hand, establishing this strategy to deter the hostile takeover, can promote unhealthy practices and remunerate executives who underperform.

Moreover, a moral hazard problem may exist whereby the top management might deliberately act adversely toward shareholder interests to induce an undesirable takeover in order to collect on the golden parachute.

Jensen (1988) found a resolutory way to eliminate issues related to contracts that award inappropriately high payments, reduce efficiency and harm shareholders by raising the cost of acquisition and by transferring wealth from shareholders to managers. << The generally appropriate solution is to make the control-related severance contracts pay off in a way that is tied to the premium earned by the stockholders >>[28]. This means that the golden parachute must reward top management for negotiating large takeover premiums.

[27] (Machlin, Choe, & Miles, 1993)
[28] (Jensen, 1988)

2.2.2 POST-OFFER DEFENSE

Post-offer defenses are used by the target company once it receives the hostile takeover bid by unwanted suitors. Unlike pre-bid defense strategies are more structured as proactive steps to deter the hostile bid, the post-offer mechanisms are employed when the acquirer has approached the target firm and there is a real threat of a hostile takeover.

a. **Stock repurchase**

The stock repurchase is a hostile takeover defensive strategy according to which the target company buys back its own shares to reduce the number of shares that could be purchased by the unwanted acquirer. << This tactic reflects the belief that when a firm initiates a tender offer for a portion of its own shares, the shareholders who offer their shares for sale are those most susceptible to a tender offer by a hostile bidder. This leaves the target firm's shares concentrated in the hands of shareholders who are less likely to sell, thereby reducing float. So, for a hostile tender offer to succeed in purchasing the remaining shares, the premium offered would have to be higher >>[29].

Hence, the potential acquirer might be discouraged by the higher price to pay to take over the target firm.

However, this deterrent strategy has a drawback. The buyback may reduce the number of shares outstanding, therefore, it will give to the hostile bidder the possibility to gain control over the target company by buying fewer shares and thus achieving the controlling stake.

[29] (DePamphilis, Mergers and Acquisitions Basics: All You Need To Know, 2011)

The stock repurchase is also seen as a way to signal to the target shareholder manager's private information about the value of the firm. The target manager will repurchase the target's shares only if the cost to do it is not too high. << Since the cost is inversely related to the value of the firm under his management, a repurchase signal that the value of the stock is high >>[30]. This positive signal should convince stockholders not to sell shares to the unwanted bidder, thus blocking the takeover.

b. Leveraged recapitalisation

The leveraged recapitalization, also known as a shark repellant, is an anti-takeover technique dealing with the changing in the capital structure of the target firm. It consists of a series of corporate finance transactions designed to affect the equity and the debt structure of the company. In particular, the shark repellant is a corporate strategy in which the target firm takes on significant new debt reducing the company's equity. The money borrowed is employed either to pay a large dividend to the shareholders or to buy back its own shares. This will reduce the firm's equity and increase its debt. Prof. Ian Giddy of the University of New York said: << The result is a far more financially leveraged company, usually in excess of the "optimal" debt capacity >>.

Adding debt to the target's balance sheet will make it less appealing for the bidder, hence, the large debt exposure acts as a shark repellant protection from a hostile takeover.

[30] (Bagnoli, Gordon, & Lipman, 1989)

c. Leveraged buyout

The leveraged buyout is used as a reaction to the hostile takeover activity and has to do with the purchase of the target company with debt financing by the management. More precisely, it is a << going-private transaction involving a tender offer for all of a firm's common stock, financed mostly by debt, made by a group usually involving some members of incumbent management >>[31].
Management buys out the shareholders' public shares at a premium and
<< engages in the value-enhancing asset redeployments >>[32] to defend the vulnerable target company, that from public becomes private, from the hostile attack.
The asset redeployment concerns the strategic reallocation of the target's assets changing their destination of use from a less profitable application to a more profitable one. Therefore, managers will employ capital to increase the firm's profitability justifying the expected higher value of the target's stock after the share repurchase. In doing so, they avoid being a victim of a hostile takeover.

d. Greenmail

The Greenmail defense refers to buying back shares by the target company from the hostile bidder who has already acquired a significant number of shares in the target threatening a hostile takeover. The target company is forced to purchase its own shares at a considerable premium over the current market price to deter the unwanted takeover.
The greenmail defensive strategy is accompanied by an additional defense, that is the Standstill agreement. According to this agreement, the unwanted acquirer

[31] (Jarrell, 1992)
[32] (Jarrell, 1992)

undertakes not to acquire any more shares of the target company within a certain period of time. Therefore, the target company repurchases its shares from the bidder at a premium, in exchange for the bidder's agreement not to make a hostile bid over a given time span.

In the greenmail defense strategy, there is a strong analogy with blackmail.

The acquirer blackmails the target company that is forced to pay a premium, through the share buybacks, in order to persuade the hostile bidder to cease its takeover attempt.

This strategy ends up in a deep money expenditure by the target company and in a significant profit for the hostile acquirer.

A famous example of a greenmail defensive technique involved Goodyear Company and Sir James Goldsmith. << In 1986, Sir James Goldsmith held an 11.5% stake (at an average of $42.20 per share) in Goodyear Company and threatened to take over the company for $4.7 billion ($49.0 per share).

In response, Goodyear agreed to repurchase the existing shares from Sir James for $49.50 per share ($620.7 million) contingent that Sir James refrain from purchasing any Goodyear stock for 5 years. In the end, Sir James made about $93 million in profit.

Additionally, to prevent another takeover attempt in the future, Goodyear offered to repurchase 40 million shares, with 109 million shares outstanding, at $50 per share, in an open offer to all shareholders. Ultimately, the purchase of 40 million shares cost Goodyear $2.6 billion >>[33].

[33] (CFI Teams, 2020)

e. Crown Jewel

The Crown Jewel is a reactive defense against the hostile attack and involves either the sale of the most valuable assets, the crown jewels, of the target company to a favored third party at a discount to the market price or the spin-off of those assets into a separate entity.

The rationale behind this defensive strategy is to deprive the potential acquirer of the most prized and valuable units in terms of profitability, market value and future business prospects that belong to the target company making it less desirable.

The target company can set anti-takeover clauses which coerce the sale of its crown jewels if a hostile takeover occurs. When there is a takeover attempt the goal of the acquiring company is to obtain the information and operations that structure the crown jewels of the target, hence, taking away the crown jewels from the firm will ward off the hostile takeover, since the unwanted acquirer would not receive the desired information or operations if it proceeds with the takeover.

It comes due to highlight that in a crown jewel defense, the target company is intentionally destroying a part of its value and damaging itself to get away from the hostile takeover. However, if the target company decides to sell its crown jewels to a friendly third party and the hostile bidder retracts its offer, it can purchase back these assets at an agreed-upon price, clearly at a slight premium, without destroying the firm’s value.

f. Pac-Man

The Pac-man defense is a mechanism employed to ward off the hostile takeover attempt and consists of the target's tender offer for the acquirer's shares, attempting a takeover of its own. The target company begins to buy up a controlling number of shares in the acquirer to gain control over it, just as the acquirer attempts to buy the majority of shares to obtain a controlling interest in the target. Therefore, the acquirer will give up on its attempt to take over the target if it is afraid of losing control over its own business.

To counterattack, the target firm needs to have enough financial resources to launch a counterbid to buy shares in the attacking company to take control over it. The defending firm may use several types of resources to generate cash to threaten the unwanted acquirer. These are:

- *Selling its own cash equivalent or non-vital assets*
- *Selling non-core business units*
- *Borrowing cash from lenders*, issuing bonds or even issuing additional stock shares with the supplementary effect of diluting the target's equity and making it harder to gain control over the firm
- *Employing the war chest*, that is a sort of risk provision in which the company stores cash to be used in case of adverse events

The Pac-man defense recalls the Pac-man game in which the player is followed by ghosts and needs to find a way to not be eliminated. If the player eats a power pellet acquires the power to turn around and eliminate the ghosts. The analogy in the anti-takeover defense is the eating shares of the attacking firm by the target company that gives the target the power to fend off the hostile takeover.

The most famous example of a company using the Pac-man defense occurred in 1982 when << Bendix Corporation tried to take over the aggregates and heavy building materials firm, Martin Marietta, by obtaining a controlling interest in Martin Marietta stock.

Martin Marietta's management sold off multiple business segments and borrowed over $1 billion to fight the takeover attempt. Bendix Corporation owned over 70.0% of Marietta's stock while Marietta bought over 50.0% of Bendix's stock through a tender offer. This fight damaged both companies as they expended huge amounts of cash to buy each other's shares. In the end, Allied Corporation acted as a white knight and acquired Bendix Corporation >>[34].

g. White knight

The White knight is an anti-takeover mechanism that deals with a welcoming acquisition of the target company by a friendly third party when the target firm is about to be taken over. The strategic partner company makes a friendly bid at a fair consideration to buy the target firm and to contrast the black night, that is the company that makes an unwelcome hostile takeover bid.

The target company accepts the fact of being taken over since the white knight, that is the company that makes the friendly bid, will offer to the target better takeover terms and a promise to keep the current management in place, preserve the company's core business and provide shareholders with enhanced value.

Together with the white knight, the target company could be also approached by other two entities with different scopes.

[34] (CFI Teams, 2019)

The grey knight is a third-party potential bidder that lies in the middle between the white knight and the black knight since it is a friendlier alternative but not so kind as the white knight. In other words, the grey knight launches a welcoming bid to acquire the target company but still seeks to serve its own interests. It makes a higher offer which is considered unsolicited after a takeover bid is made by the white knight.

A yellow knight is, instead, a company that was planning a takeover attempt of the target company but then backs out and proposes a merger of equals with it.

An example of a White knight occurred in 2008 when the << global investment bank Bear Stearns sought a white knight after facing catastrophic losses during the global credit crisis. The company's market capitalization had declined by 92.0%, making it a potential target for a takeover and vulnerable to bankruptcy. White knight JPMorgan Chase & Co. (JPM) agreed to purchase Bear Stearns for $10 a share. While this was a far cry from the $170 a share the company traded for just a year earlier, the offer was up from the $2 a share JPMorgan Chase initially offered shareholders >>[35].

h. White squire

The White squire hostile takeover defense strategy has some analogies with the white knight. The target company gives a friendly third party a certain amount of ownership in the target without acquiring it. In particular, this strategy entails defending the target against the hostile acquisition by preventing the hostile bidder to gain control over it by freezing out[36] minority shareholders. Therefore,

[35] (Palmer, 2022)

[36] A freeze out, also called a shareholder squeeze-out, is the action taken by the majority shareholders in a firm towards the minority shareholders to force them selling their stakes in the company. Under the contest of a White squire, the minority shares are sold to the friendly third party to prevent the hostile takeover.

the purpose of this mechanism is to buy just the number of shares of the target large enough to stop the hostile takeover and give the target company time to improve or change its defensive strategy. The deal provides for a seat on the board, discounted shares, or generous dividends for the white squire in exchange for its help in rescuing the target firm.

Once the unwanted acquirer withdraws its bid, the white squire can sell its shares in the target company with the prohibitive clause not to tender its shares to the hostile bidder.

Although the white squire helps the target firm to block the bidding company, it may change its mind. Therefore, the target company can assure a seat on the board of directors for the friendly investor, requiring it to vote in favor of the target company. Moreover, to prevent a white squire to damage the company, later on, the target should enforce a standstill agreement that imposes on the friendly party not to raise its stake in the company.

An example of a white squire strategy occurred in 2016 when << Gannett Co. made a takeover bid for Tribune Publishing Co. The takeover bid was $12.25 per share in cash, worth about $820 million. The management team of Tribune declined the bid, deciding that the price understated the true value of the company and was not in the best interest of its shareholders.

Despite the rejection of their takeover bid, Gannett said it was committed to pursuing the deal and attempted a proxy fight. Gannett urged shareholders of Tribune to withhold their votes during Tribune's annual meeting to send a message to the board of Tribune to seriously consider its offer.

In May of 2016, billionaire Patrick Soon-Shiong invested $70.5 million in Tribune. By doing so, he became the company's second-largest shareholder. The

billionaire was deemed a white squire for purchasing a large number of shares to help fend off Gannett Co's takeover attempt >>[37].

i. Litigation

Litigation is one of the post-offer defenses and it is perhaps one of the most used during a hostile takeover. It deals with filing a suit against the bidding firm for violating antitrust or securities regulations. The litigation defense serves two different purposes. It delays the bidder attack and therefore the target firms can benefit from receiving other offers thereby encouraging the competition between the bidders. The lawsuit will extend the negotiation period of time before the target company's board is required to reply to the bid. The second purpose is to push the unwanted acquirer to raise the offer price to induce the target company to drop the suit and thus avoid paying for legal expenses. This strategy puts the target company in the position to choose which bid is better off, among different potential acquirers that will increase the offer price to get the deal or to be uncharged for their professional misconduct.

j. "Just say no"

"Just say no" it's a strategic decision the board of directors of the target firm can make to push away a takeover attempt once they receive the hostile bid. It consists of just saying no to the negotiation of any deals and of refusing outright whatever bidders may offer. This approach enables the board to reject offers outright only if the target is engaged with the development and the application of a long-term corporate strategy such as a merger with a firm other than the one that has proposed the hostile bid. The target is justified as well to just say no to a takeover bid if the offer undervalues the company itself.

[37] (CFI Teams, 2019)

At the end of the day, this tactic wishes to obtain the best proposals, hence, it encourages better offers in order to choose the one with the highest bid price from the potential acquirer or from a friendly white knight to create or increase value for its shareholders.

However, the “just say no” defense is not always in the best interest of the shareholders because the board members can employ this strategy by refusing an offer even if it has a considerable premium to the current market price of the target’s shares. Sometimes the decision to adopt this approach results to be a failure since the target company would have been better off accepting the deal. One example of a company’s failure with the “just say no” tactic is Yahoo when it refuses to be taken over by Microsoft for $44.6 billion in 2008, ending up selling off its core business several years later for $4.83 billion.

2.3 ROLE OF THE INVESTMENT BANK IN HOSTILE TAKEOVER DEFENSE AND TARGET'S SHAREHOLDER VALUE MAXIMIZATION

Once the target company receives the hostile bid, the Chief Executive Officer advise the board of directors and his/her legal and financial advisors. In particular, the target's financial advisors are asked to review the financial adequacy and fairness of the bid and to look for and obtain details on the financial and monetary stability of the bidder. If any, its track record in other bidding situations is also considered.

The choice of the investment bank which serves as a financial advisor is hard to make. The target company will need a candidate with specific expertise, which is preferably in the location of potential white knights and with moderate fees to be paid. Together with advising the target company on the hostile bid, evaluating the offer, providing information, and furnishing an opinion with respect to the adequacy and fairness from a financial point of view, the hired investment bank assists its target client in developing and implementing strategic alternatives to the hostile bid.

Pursuing the target company's defense against the hostile takeover, financial advisors are entitled to draw up a list of potential white knights that have the suitable financial features to match those of the target firm and to finalize the friendly acquisition with favorable terms. Before starting the negotiation with the friendly investors, which takes a lot of time, the investment bank helps the target company put into play a shareholder rights plan, the poison pill, to gain the time they need to structure and adopt a defensive strategy to respond to the hostile bidder, pushing it to raise the offer price.

Indeed, << when a public company receives a hostile takeover offer at a price that is attractive to a majority of its stockholders, it may leverage its takeover defenses

to get a better deal or find a better offer, but its days of independence are probably numbered >>[38].

The crucial work of the financial advisor is to evaluate the hostile bid and then recommend to the board of directors what to do with it. << If the hostile bid is significantly below the financial advisors' estimates of a target's fair-market value, chances are better that a "just say no" defense may succeed >>[39]. Alternatively, they should seek to complete an alternative transaction with a potential white knight by conducting a formal bid, or even, an auction process among the interested bidders. The final goal of the investment banks is always finding alternatives that better maximize the target's shareholder value.

Therefore, the challenge for the investment bank and the executives of the target firm is to determine the best defense strategies to undertake, before any attacking bids are received, to best fortify shareholder investments and maximize their wealth. Then, once the hostile takeover attempt occurs, the board should decide if facilitate the takeover or not, based on the financial advisor's evaluation of the offer. << Facilitating the takeover may result in short-term share appreciation, but the associated loss of the company's strategic agenda or governance team may result in longer-term stock price declines. Alternatively, by maneuvering to defeat the takeover, the firm's executives may produce modest stock value increases as other investors gain a heightened understanding of the firm's strengths. However, such actions may deprive stockholders of a rare opportunity to bolster their returns as a result of a pursuer's special interest in the company >>[40].

[38] (Gordon, 2002)
[39] (Shaw, 2020)
[40] (Pearce & Robinson, 2004)

Moreover, if the target company decides to "just say later", implementing defensive strategies, << such resistance may also discourage a suitor that believes the target has priced itself out-of-reason, thereby depriving the stockholders of an attractive one-time market premium >>[41].

At the time of the announcement of a defensive activity against a hostile takeover, the market price of the target's shares declines, because the market perceives the financial weakness of a company attacked by a hostile bidder. Therefore, in the short-run, speculation, and high information uncertainty lead to a decrease in the value of the company. Nonetheless, when the negotiation starts and executives actively pursue a defense strategy, the target company acquires value because fighting against the unwanted suitor, produces increased bids and higher stock prices, eventually resulting in positive reappraisal and wealth gains for its shareholders. << Especially when executives support a poison pill provision to repeal a hostile attack or encourage litigation to extend the negotiation period between the two companies, the defense is likely to boost shareholder wealth. Moreover, because these defenses are largely free of the specter of self-serving executive motivation, they enhance the alignment between the embattled company's stockholders and their corporate leaders, thereby adding to the prospects of success for the firm >>[42].

[41] (Pearce & Robinson, 2004)
[42] (Pearce & Robinson, 2004)

INVESTMENT BANK'S CONFLICT OF INTEREST DURING HOSTILE TAKEOVERS

3.1 DEFINITION AND STANDARDS FOR CONFLICT OF INTEREST IN THE INVESTMENT BANKING INDUSTRY

Conflict of interest is a phenomenon that often arises in financial contests, especially in the investment banking industry. It occurs whenever more than one interest overlaps, giving birth to unpleasant situations for the parties in a deal. Merely, the conflict of interest is any actions taken by the subject at issue pursuing its own interest instead of those of the people it serves.

In the investment banking industry, conflict of interest is a risk clients may face when dealing with an investment bank. The latter acts on behalf of its clients and in their interests, hence it could seek to gain from a deal by pursuing the needs of one client at the expense of the other.

The most common form of conflict of interest in the investment banking industry arises when investment banks operate in underwriting stocks or bonds for corporate clients and in providing investment management services to individual clients. For example, the investment bank can acquire shares of the company for which it is underwriting stocks as an investment under the portfolio management it is performing for its individual client. In this case, there is a conflict of interest because the investment bank attempts to serve the needs of two client groups, that are the firm for which it is issuing the shares and the investor to whom it sells those shares.

Therefore, << conflict of interest is a type of moral hazard problem that arises when an institution has multiple objectives and, as a result, has conflicts

between those objectives which may potentially lead to conceal information or disseminate misleading information >>[43].

In the contest of a hostile takeover, a conflict of interest arises when the investment bank advises two clients at the same time on the same deal. It can also occur when the investment bank involved in advising one client exploits the information it obtained from its former client against the latter. Therefore, how can the investment bank not fall into a conflict of interest if it advises client A while, at the same time, assisting client B in the hostile takeover of client A? And how can the investment bank be neutral after information about client A has been obtained and could be used to the advantage of client B in the hostile takeover of client A?

Clearly, the potential conflict of interest examined in this section is restricted to the hostile takeover, since targets in friendly acquisitions would be unlikely to have reason to complain about the action of the investment bank assisting the acquirer.

In a hostile takeover, the investment bank, being hired by both target and acquirer, may choose to pursue the interest of one of the two of its clients as it is in line with its own needs. << It is common for an investment bank to work for client A while assisting client B in the acquisition of client A. Although the academic literature has not covered this specific issue, news stories indicate that such behavior does occur and does not violate laws or regulations so long as the

[43] (eimf, 2018)

investment bank does not pass confidential information from the target to the acquirer >>[44].

Thus, the standards for conflict of interest in the investment banking industry are:

- *The concentration of the investment banks in representing client firms* that could have adverse interests.
- *The transmission of Private Information* of a company in assisting another client in a deal.

3.1.1 INVESTMENT BANK’S CONCENTRATION IN REPRESENTING FIRMS

Investment banks can be hired by corporate clients to advise them on Mergers & Acquisitions (M&A) transactions. In particular, the investment bank is alongside its client from the beginning of the deal till its end. It can represent the company assisting in launching a hostile takeover bid or advising the target company during its defense against the hostile takeover. Usually, corporate clients choose to hire investment banks with more experience, capital and information. Not all investment banks are able to take on large deals, especially the smaller ones, therefore, those entitled to advising on significant projects will tend to merge with each other to obtain more capital and share the risk.

They create a sort of syndicate and advise all together the same client on very large transactions such as a takeover. In this way, if the deal collapses, the associated risk is shared across multiple banks.

[44] (Calomiris & Singer, 2004)

The syndicate of banks creates concentration in the industry, thus an investment bank that advised client A in the past may now assist client B in the hostile takeover of client A and this is because the investment bank that has been hired by client B, was part of the syndicate which advised client A on a former big affair.

In other words, << the need to disperse the risk of large deals combined with the tendency towards concentration means that in a large takeover or merger there is a significant likelihood that any investment bank representing the acquirer would have had prior dealings with the target >>[45].

Whatever this is the case, there is a potential conflict of interest in a hostile takeover transaction.

3.1.2 TRANSMISSION OF PRIVATE INFORMATION

When an investment bank has a professional relationship with two corporate clients that have adverse needs, it could occur that the information collected from one corporation to pursue its own interest is then shared with the other client in carrying out an opposing deal against the former client. This is the case of a potential conflict of interest of the investment bank advising in a hostile takeover deal.

Therefore, if the investment bank does not exploit the knowledge of sizeable undisclosed data about a company to advantage another party in the deal, there is no conflict of interest.

Although such overlapping relationships do not constitute a breach by the investment bank, it violates the law if the potential conflict of interest occurs

[45] (Calomiris & Singer, 2004)

through the flow of secret information that is used to benefit one single party in the deal.

a. Potential conflict of interest and implications in the acquisition premia

The potential conflict of interest in the transmission of private information occurs when the investment bank obtains some secret and crucial information about a company that, if spread, could affect the outcome of the final deal between the two parties, the acquirer and the target company, during a hostile takeover.
In other words, if the investment bank has been hired by client B for the takeover of client A and the investment bank shares considerable and strategic information about client A, that are material to the takeover, to client B, this could affect the price client B is willing to pay for the takeover of client A. It follows that the public revelation of this important information significantly affects the abnormal returns of the stock price of client A.
Comparing a situation in which there is a potential conflict of interest for the transmission of private information and that in which there is no potential conflict of interest, it is expected that when client B knows something strategic important for the takeover of client A, the acquisition premia paid by client B suffers greater variation in respect to that for which no information has been shared with client B. This is because once client B has knowledge about crucial aspects of client A that are relevant to the takeover, it can decide to offer a higher premium or a lower one, depending on the characteristics it catches about future synergies and gains it can exploit acquiring that target company.
Calomiris and Singer (2004) with their research paper, have analyzed the distribution of premium for deals with a potential conflict of interest and without

a potential conflict of interest. Their result is that, since there are notable differences in the two distributions, it means that it is possible that some information may be transferred from some of the conflicted banks to the acquirers during a hostile takeover.

Indeed, they found out that for deals with a potential conflict of interest, a larger portion of targets attracts a very high premium. On the other hand, the number of acquisitions is strongly reduced since acquirers use private information to avoid targeting some lower-quality targets. The chance of the targets getting a small acquisition premium is truly far, rather they will not receive the offer at all, therefore there is no damage to the targets in hostile takeover activity.

However, although there are differences in the distribution of the acquisition premia between the potential conflict of interest scenario and the situation without the potential conflict, their findings are not statistically relevant to demonstrate that the abuse of private information is the factor which affected the variation of the acquisition premia offered by the acquirers and that it has been the investment bank to transmit private information to the bidders.

Indeed, the acquisition premia could not be affected by the conflict of interest in the transmission of private information, but it may variate depending on other aspects during the acquisition process. Often, acquirers hire investment banks for the evaluation of the target firm and the following negotiation, and this can affect the acquisition premia to be paid. << In situations where there is greater transactional ambiguity and information asymmetry in the form of acquirers purchasing unrelated targets, targets that operate in many business areas, and in non-cash financed acquisitions >>[46], the acquirer relies on the investment banks,

[46] (Porrini, 2006)

especially on those with a first-tier status, for their expertise and judgment in formulating the acquisition offer.

As a result, the choice of the acquirer to hire a first-tier investment bank particularly when the acquisition is characterized by transaction-specific attributes is associated with greater acquisition premiums[47].

b. Possible ways out: Chinese walls and written agreements on disclosures

The potential conflict of interest in the transmission of private information by an investment bank in its advising role could be deterred through the structure of Chinese walls or by introducing written agreements on disclosures.

The Chinese wall restricts access to secret information to maintain confidentiality with the related client and to prevent conflicts of interest.

The term Chinese wall describes a virtual barrier used to block the exchange of information inside the financial institution giving clients the discretion on their private information.

The Chinese wall policies can be used by the investment bank to self-regulate their business dealings by generating ethical boundaries between the different departments or project teams to prevent the sharing of non-public information provided by clients that might lead to ethical or legal violations. Therefore, investment banks may have an incentive to do so, even if the client has not requested such action, to reduce the possibility that undisclosed data may become abused. Furthermore, investment banks decide to build a Chinese wall also to better attract clients that might otherwise be concerned about potential conflicts of interest with antagonistic firms.

[47] (Porrini, 2006)

INVESTMENT BANK'S CONFLICT OF INTEREST DURING HOSTILE TAKEOVERS

There is a conflict of interest during a hostile takeover once the private information, that is material to the takeover, breaches the Chinese wall and, consequently, the public revelation of that information affects the abnormal returns of the target's stock price.

Hence, if the Chinese wall is effectively erected inside the investment bank, the latter can advise its target client in the defense against a hostile bid and, at the same time, assist its acquirer client in launching a tender offer to take over its target client. Just as, the investment bank can advise its acquirer client on the takeover of one of its former clients since there not should be a flow of non-public information between the different departments of the bank engaging in opposite deals.

Another possible way out of a potential conflict of interest is a written agreement on disclosure. The client should ask the investment bank it hires for a written agreement on disclosure to ensure the confidentiality of the information. This time, it is at the description of the client to obtain the assurance about disclosure if it is afraid that revealing such material secret information about its business to the investment bank could be of interest to a competitor.

There may be a potential conflict of interest if the client does not ask for a written agreement about disclosure and if the investment bank does not maintain confidentiality. Therefore, it is the client's responsibility to secure confidentiality agreements before providing private information, but it is conditional on such agreements being secured, the investment bank's responsibility to protect confidential information.

3.2 AGENCY THEORY AND DUAL ROLE ADVISOR IN BIDDER AND TARGET’S REPRESENTATION

During hostile takeovers, the investment bank that works as advisors of the acquirer and/or the target company may incur a potential conflict of interest that affects the final outcome of a deal.

The investment bank’s potential conflict of interest figures in two different cases depending on the role it assumes when it is hired. It could occur that the investment bank is hired by both the acquirer and the target firm to simultaneously advise on a deal between the two abovementioned parties. It can also arise between the target firm and its advisors and between the acquirer company and its advisors. Therefore, in this case, there won’t be an investment bank between the acquirer’ and the target’s interests, but it will stand in front of its target client’ or its bidder client’s needs. This is what is commonly named agency theory. The executives of both target and bidder firms often rely on investment banks to be advised on mergers and acquisitions transactions to improve the efficiency and the effectiveness of the negotiations, hence, the investment bank, which represents the party in a deal, acts as the agent while the firm involved in the operation act as the principal.

In an agent-principal relationship may occur that the interests of the agent and those of the principal are at odds and thus the advice of the investment bank may not be in the best interests of the client. For example, the acquirer firm could find itself bidding far beyond the reasonable value of the target company and its resource constraints because encouraged by a self-interested investment bank.

Indeed, the misalignments between the agent’ and principal’s interests may result from the incentives that the target or the acquirer typically gives to the investment

bank. If the agent is provided with a considerable remuneration resulting in a huge profit for it, there won't be a potential conflict between the advisor's own interests and those of the hiring firm. If instead, the investment bank percepts that can gain more than the compensation it is receiving, there will be a misalignment of interest since the investment bank is pushed to pursue its own goals. As Lax and Sebenius (1987) said in their research paper: << Consider a merger negotiation in which the investment bankers are paid on an hourly basis if there is no deal but a percentage of the sale price if a deal results. Such arrangements are likely to result in more frequent but less advantageous mergers than if the bankers' incentives were lined up more perfectly with those of their principals >>. Therefore, the investment bank, in all negotiation situations for its clients, continuously, experiences a negotiator's dilemma according to which it must choose whether to use collaborative tactics which create value for both the agent and the principal, or opportunistic tactics that generate too more value for itself and less or no value for the clients[48].

The potential conflict of interest of the investment bank in its advisory role lies in the contract agreed upon for its services in tender offers. Most fee contracts are considerably contingent on tender offer outcome; << typically, the fee for the target firm's banker is a function of offer value and the fee for the bidding firm's banker is a function of the number of shares purchased >>[49].

These contracts create the potential for conflicts of interest because the incentives for bankers influence how they provide services to the shareholders which results in a misalignment of interests.

[48] (Lax & Sebenius, 1987)
[49] (McLaughlin, 1990)

<< The bankers' services fall into three categories:

- *prior search* - locating potential bidders or targets,
- *effort* - working to complete offers, seeking higher bids, defending against hostile offers, and negotiating,
- *offer evaluation* - advising on bidding strategy, on the offer price, and on the accept/reject decision, and evaluating the potential for competitive bids>>[50].

The conflict of interest created by the incentives contract leads to less ideal solutions for shareholders, in particular, a bidding-firm contract provides no incentives for the investment bank to minimize the premium paid for the acquisition and a target-firm contract in a hostile bid contains incentives for the investment bank to complete the hostile transaction.

To eliminate the risk of conflicts between the interests of banker and client in a deal, McLaughlin (1990) proposed alternative contract forms that can be applied. He introduced the total-value contract paying the same percentage of firm value for no transaction and for acquisition and, in this way, aligning the payoffs to bankers and shareholders.

For target firms, he recommends an alternative contract to eliminate the incentives of the bankers to complete resisted offers by limiting the payment of the fees to the board approval for the acquisition; therefore, the investment bank has no interest in working against the target firms since its incentives are now to arrange and/or complete an acquisition that the board would approve.

[50] (McLaughlin, 1990)

For bidding firms, the alternative contract he proposes is a reverse total-value contract which provides a fee that is contingent on the acquisition price and is also a decreasing function of the offer price; thus, the investment bank will manage the offer in order to maximize the surplus to the bidder aligning its own interests and those of the company shareholders.
However, these alternative contract forms are not often used since they do not solve the agency theory because bankers can still act against the interest of the client company’s shareholders and also, they can be easier controlled by the reputation they have in the market in properly acting for their client’s needs.
The agency theory suggests the potential conflict of interest standing in between the different goals and objectives of the parties involved in the hostile takeover. For target firms, the goal is to negotiate the highest possible premium over its current share price while for bidding firms the goal is to minimize the price paid for target firms. Therefore, because of its advising role alongside the acquirer and the target company, the investment bank will choose to act for the target or for the bidder’s sake. << Theoretically, then, the actions of the investment bankers representing each side should reflect these divergent goals—the targets' investment bankers should seek the highest possible premiums, and the bidders' investment bankers should strive for the lowest premiums. Interestingly, however, since the fees paid to bankers are typically a percentage of the total value of a deal (McLaughlin, 1990), the investment bankers of both target and bidding firms benefit more from higher premiums. Consequently, the bidding firms' goal of minimizing the premiums paid conflicts with their bankers' objective of maximizing fees for banking services. This is not the case for target firms and their bankers because both receive greater benefits from higher

premiums >>[51]. The result is that there is a potential agency problem between the hostile bidders and their investment banks.

When the investment bank work as an advisor to a firm targeted in a hostile bid and simultaneously is involved in providing finances for the bidder of the deal, a conflict of interest could arise. << Being a dual role advisor could raise a fear that the investment bank's advice to the seller throughout a bidding process is tainted by a desire on the part of the advisor to obtain additional fees from financing the successful bidder. Thus, a dual role advisor may create conflicts of interest with the selling shareholders to the extent that the advice is skewed by the advisor’s concern about the profit it earns from lending to the bidder >>[52]. Hence, the investment bank engaging in a dual role advising deal pursues the interest of the hostile bidder at the expense of the target company, giving birth to a conflict of interest between the bankers and the target’s shareholders.

Siming (2009), in his research paper, studied several implications that a dual role advisor can bring to a deal. He found out that the average premium paid in a deal, measured as the offer price over the share price one month prior to the announcement, is 12.0% lower for dual role deals compared to deals without a dual role advisor. Moreover, he obtained as a result of his analysis that the acquirer gains a cumulative abnormal return around the announcement day of 1.9% higher in deals with a dual role advisor. Further, he discovered that deals involving a dual role advisor are more often subject to lawsuits by target shareholders than deals without and that the merger advising fees collected by the investment banks are lower because the dissatisfied shareholders pay their advisors relatively less.

[51] (Golubov, Petmezas, & Travlos, 2012)
[52] (Siming, 2009)

Eventually, its results demonstrate that the investment bank hired by the target company may not fulfil its obligation of improving the pricing of the transaction and suggest to the target to be careful in inspecting the activities of its advisor and to demand full disclosure of which activities the investment bank is engaging in or planning to engage with the hostile bidder.

3.2.1 RELATIONSHIP BETWEEN PREMIUMS PAID IN DEALS AND INVESTMENT BANKING MERGER FEES

When the acquirer company and the target company decide to hire an investment bank to be advised on a deal, they need to pay for its services the merger fees. The payment of the merger fees is strictly related to the premium paid in the deal; it might be also influenced by the choice of the investment bank.
As it was previously said, the acquirer and the target have conflicting goals, the former would try to minimize the premium to be paid to buy the target, while the target has incentives to maximize the level of the premium.
Chahine and Ismail (2009) studied the implications of investment bank reputation and merger fees on the level of the premium paid at the time of the deal announcement.
The results suggest that while the bidder hires a more reputable investment bank and pays a larger fee to reduce the acquisition premium; the target firm hires a renowned investment bank and pays a larger fee to be advised on the defensive strategies it should put into play to increase the premium received. Therefore, there is a positive association between the target fee and the level of the premium, whereas the acquirer fee is negatively related to the premium. Moreover, the findings also demonstrate that when acquirers pay higher fees than targets, they

end up paying lower premiums too. However, there is no evidence on the effect of the investment bank's reputation on the acquisition premium, it is strictly related to the amount of merger fees to correspond.

Finally, the results also show that target firms pay lower fees in friendly deals but higher fees in deals with larger acquirer pre-merger ownership as in a preliminary step of a hostile takeover.

3.3 CASE STUDIES OF INVESTMENT BANK'S CONFLICT OF INTEREST IN HOSTILE TAKEOVER ATTEMPT

The following case studies aim to highlight the potential conflict of interest that can occur when an investment bank acts in its advisory role for both the target and the bidding firm.

The first case study shows how the investment bank finds itself in a conflict of interest advising the hostile bidder for the takeover of one of its former clients. Since the investment banking industry is characterized by investment banks' concentration, these financial institutions converge in a syndicate to share capital and risk to afford such big deals as hostile tender offers. Hence, most investment banks which advised clients on past deals can be hired to assist current clients in dealing with their previous clients, giving birth to possible fights.

The conflict between the interests of the acquirer and those of the target company arises due to the potential transmission of private information of the target company by the investment bank to its bidding client to advantage the latter in the success of the hostile takeover attempt.

The second case study is focused on the dual role advisor of the investment bank when it assists simultaneously the target firm in a hostile acquisition and the bidding firm on its deal with another firm. Therefore, the potential conflict of interest that might arise involves the investment bank choosing which needs to satisfy and at expense of whom to gain on the deal. Again, the conflict between the interests of the two parties in the deal appears in the potential sharing of trade secrets by the investment bank to the bidding part of the agreement.

Does the investment bank act for the target or the bidder's sake?

3.3.1 GOLDMAN SACHS REPRESENTING VODAFONE AIRTOUCH, PLC. IN THE HOSTILE TAKEOVER ATTEMPT OF MANNESMANN, ITS FORMER CLIENT

On 13 November 1999, the British telecommunications company Vodafone Airtouch PLC. announced a takeover bid for the German telecommunications and engineering group Mannesmann AG based on a stock-for-stock transaction. Goldman Sachs, a leading global investment banking, securities and investment management firm with headquarter in New York, was hired by Vodafone to launch a hostile tender offer against Mannesmann. The takeover was one of the largest merger and acquisition (M&A) deals in the world, worth nearly $ 200 billion.

Vodafone and Mannesmann were publicly considered coalition partners till November 1999. After the takeover of Airtouch, an American wireless telephone service provider, Vodafone became a market leader as a mobile telecommunications provider and shared with Mannesmann joint participation in E-Plus, a mobile telecommunications operator in Germany recently taken over by Telefónica Germany. Moreover, Vodafone came to control almost 35.0% of Mannesmann Mobilefunk, previously held by Airtouch, giving it a toehold in the takeover bid.

In the meantime, in October 1999 Mannesmann made a takeover bid for Orange, a British mobile network operator and internet service provider, which threatened Vodafone's home market and triggered it to launch a takeover offer to acquire Mannesmann. Indeed, on November 14 a friendly merger bid was made.

Mannesmann's board of directors decided to reject the friendly tender offer by Vodafone on November 19 because the proposal was apparently inferior compared to the value of the company. The offer involved a swap of 43.7

Vodafone shares for 1 Mannesmann share results to be in an extremely unattractive offer for the shareholders. In addition to the disadvantageous offer, Mannesmann's management was unfavorable to the takeover because of the large strategic, economical, and structural differences between the two companies, since Vodafone concentrated its business on mobile phones while Mannesmann had a business model, focused on engineering, automotive, telecommunications and seamless tubes, that makes it more diversified.

In December 1999, Vodafone come forward with a new offer directly proposed to the Mannesmann shareholders to exchange their share in the ratio of 53.7 Vodafone AirTouch shares for 1 Mannesmann share, as a pure swap with no cash component. With this unsolicited takeover bid, the battle started. Vodafone justified its unsolicited takeover bid by asserting, in the industrial logic of a merger, that it would have contributed to the growth of Mannesmann. As a matter of fact, Mannesmann was portrayed as a baby that needs a good mother, Vodafone, to grow.

Before the hostile bid was made, Vodafone and Mannesmann engaged in public advertising campaigns for the loyalty of shareholders. The exchange of announcements began with Mannesmann with its aggravating announcement and the answer of Vodafone was not long in coming; it advertised the picture of a mother feeding her baby with the caption "Every Mann knows: If you want to grow, you need a good mother". Mannesmann replied with a new ad showing a baby who said, "A hostile mother is the worst thing in the world".

To defend itself from the unsolicited takeover bid, Mannesmann tried to engage in the sale of Orange as a poison pill strategy to prevent a monopolistic market position from Vodafone in British, thus diluting its power and deterring the hostile takeover.

During the takeover battle, Mannesmann was advised by Morgan Stanley, Merrill Lynch, and J.P. Morgan. Meanwhile, Vodafone worked closely with Goldman Sachs and Warburg Dillon Read. As advisors, investment banks play a central role in mergers and acquisitions, especially during hostile battles where banks are doubly involved: as consultants to the acquirer firm and in the development of defensive strategies for the target company. Therefore, due to high concentration in the M&A market, target firms, like Mannesmann, may have difficulty in finding and hiring advisors that are not or were not involved with the bidding firm.

In November 1999 the CEO of Mannesmann, Klaus Esser << demanded that Goldman Sachs should stop advising Vodafone. Since Goldman Sachs had advised Orange in its friendly merger with Mannesmann, Esser argued that Goldman Sachs had access to inside information. As a result, Goldman Sachs temporarily halted its consulting activity. Meanwhile, Mannesmann filed a petition at the High Court in London to have Goldman Sachs suspended from acting as a consultant, but the suit was refused >>[53]. It was found out that Goldman Sachs wasn't in possession of confidential information from its past involvement with Mannesmann, and that a senior Mannesmann executive, Kurt Kinzius, had backed away from crucial evidence he made to the court. Initially, he said he was present at a meeting in March in which Goldman Sachs made assurances to the CEO of Mannesmann, that the bank wouldn't act in a hostile bid against the German company; Then after he admitted he wasn't at the meeting but was told of what happened by Mr. Esser.

[53] (Höpner & Jackson, 2001)

<< In its submission to the court, Goldman Sachs said it won't act for bidders on a hostile takeover for an existing client, but might act against a former client as long as it can "do so consistently with any obligation of confidence owed to former clients." >>[54].

<< Goldman Sachs issued a terse statement: “Goldman Sachs believes it has acted entirely properly and has pressed for an early hearing so it can challenge this action vigorously” >>[55]. It proved it would not have transferred the private information of Mannesmann to Vodafone dropping the charges against it by Esser who accused the investment bank of conflict of interests. The Mannesmann CEO said << “I don’t’ think it is proper when Goldman Sachs takes our documents and goes to Vodafone.” He was appealing to stock market rules in London that guarantee fair play. He added, “Goldman Sachs should be so kind and play the rules” >>[56].

Finally, << the court also said it was skeptical about the company's motives in filing an injunction just days before an expected bid from Vodafone >>[57].

The takeover battle was about to finish when Mannesmann failed in its most efficient strategic defense, closing a deal with a white knight.

The French mass media holding company, Vivendi, could have become a strong partner in the takeover defense by merging its telecommunication division with Mannesmann’s core business. The latter would have accepted the unsolicited offer only if it had had the majority in the new company after the acquisition by Vodafone. << By the end of January, Vodafone entered negotiations with Vivendi and sought to win them as a possible buyer of Orange following the

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[54] (Erik Portanger Staff Reporter, 1999)
[55] (Valdmanis, 1999)
[56] (Portanger & Lipin, 1999)
[57] (Erik Portanger Staff Reporter, 1999)

takeover battle. The fronts shifted, as Vivendi announced a joint Internet portal with Vodafone if the takeover succeeded >>[58]. The white knight strategy failed spectacularly.

In February 2000 Vodafone and Mannesmann come to a deal. Klaus Esser accepted the bid for a 49.5% share in the merged company against the 50.5% share of Vodafone.

3.3.2 UBS ASSISTING ARVINMERITOR IN ITS HOSTILE TAKEOVER OF DANA CORPORATION WHILE ADVISING THE LATTER FOR A POTENTIAL JOINT VENTURE

Dana Corporation, an American automobile equipment manufacturer, retained UBS to negotiate a potential joint venture between Dana Corporation and Chrysler. UBS is a multinational investment bank and financial services company based in Switzerland, which assisted ArvinMeritor, an American automobile components manufacturer, in its hostile takeover attempt of Dana Corporation.

UBS was hired by ArvinMeritor while it was representing Dana Corporation in the joint venture between Dana and Chrysler, involving Detroit axle, an axle production facility. During the representation of Dana, UBS obtained material private information that if shared with ArvinMeritor, would have advantaged its hostile takeover attempt. Therefore, UBS finds itself in a conflict of interest between Dana Corp and ArvinMeritor during the unsolicited offer.

In 2003, shortly after the announcement of ArvinMeritor's hostile takeover attempt, Dana Corporation filed a lawsuit in the United State District Court in Manhattan, New York, against UBS, to prevent it from acting as an adviser.

[58] (Höpner & Jackson, 2001)

<< According to the lawsuit, UBS has acted as an investment banker and financial adviser to Dana on a "significant corporate project" since "at least" March 2002. UBS provided "substantial financial and investment advice" to Dana with respect to the project from March 2002 through the end of May, the lawsuit said…As recently as May 23, Dana and UBS met to discuss "current material, non-public" information about Dana, the lawsuit said. (Dow Jones Corporate Filings Alert, August 5 2003) >>[59].

In the lawsuit, Dana Corp alleged that UBS used << substantial amounts of confidential information about Dana, its financial condition, its business plan and prospects, its competitive posture, its trade secrets, and its potential liabilities>>[60], to help another company in its same industry, ArvinMeritor launch a hostile takeover bid for Dana Corp. The suit also said that “all this information would be of great value and importance to ArvinMeritor in planning and executing its takeover strategy”.

Moreover, Dana Corp accused UBS of having undertaken to assist ArvinMeritor in its hostile takeover effort << “without any disclosure to Dana and without Dana’s knowledge or consent”, according to the suit. “Rather, UBS acted secretly” >>[61].

UBS defended itself against charges by asserting that the bank was committed to the highest standard of professionalism and ethics and has adopted the appropriate compliance procedures to prevent any breach of client confidentiality.

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[59] (Chang, Shekhar, Tam, & Yao, 2012)
[60] Dana Corporation v. UBS Securities LLC, SEC file 5-10058
[61] (Sorkin, 2003)

It went on to say that it << has had a longstanding, public relationship with ArvinMeritor that commenced prior to its engagement by Dana; and, at the time it engaged UBS, Dana acknowledged the potential for UBS to do business with competitors and its procedures for protecting confidentiality >>[62].

The transmission of trade secrets that causes potential conflicts of interest to arise needs to be material for the takeover to significantly advantage the bidder.

Calomiris & Singer (2004) studied the Dana Corporation case and run an economic test for the materiality of private information. They analyzed Dana's abnormal returns surroundings the announcements about the joint venture. If the joint venture had been material to the takeover, its announcement would have affected the current share price of Dana Corp. This because ArvinMeritor could have offered a premium for the acquisition sufficiently high to appeal to the shareholders, knowing that there was an important transaction going on that would have increased the market value of the target company.

The study of the impact of these events on Dana's stock price reveals that << the market did not perceive the planned joint venture to be a significant contributor to the probability of a successful takeover by ArvinMeritor, or to the price at which such a takeover would take place >>[63].

At this stage, the question that might arises is whether these complaints are founded or are just strategies the target puts into place to impede a takeover.

<< The courts are seeking to make a legal distinction between the use of information generated in the course of a banking relationship and the use of

[62] (Sorkin, 2003)
[63] (Calomiris & Singer, 2004)

information disclosed under a confidentiality agreement, the breach of which, if proven in Court, would be considered a breach of fiduciary duty >>[64].

The lawsuit against UBS came several weeks after Dana disclosed that Deutsche Bank withdrew as one of its advisers after declaring that it had previously proposed the idea of making a hostile bid for Dana to ArvinMeritor. Therefore, Dana Corp tried to force UBS to take a step back in advising the unsolicited bid by ArvinMeritor, just as Deutsche Bank did.

However, the success of lawsuits against advisers for conflicts of interest is rare. The court dismissed the case.

[64] (Ivashina, Nair, Saunders, Massoud, & Stover, 2009)

CONCLUSION

Does the investment bank act for the target or the bidder's sake?
It depends.
The investment bank acts pursuing its own interests that can be in line with those of its target or bidder client. The banker will pursue the needs of the target company by maximizing the acquisition premia which in turn raises the merger fees to correspond since these are a percentage of the total value of a deal[65]. It will pursue, instead, the goals of the acquiring company when it assumes a dual role of advisory engaging in financing the bidder during a hostile takeover of its target client. The outperformance of the bidder is strictly tied to the profit the banker can gain by providing financing services to the company.
The potential conflict of interest that arise when the investment bank represents both its target client in current or past deals while assisting its bidder client in the hostile takeover of the target takes the form of the transmission of material private information of the target to the unwanted suitor. The investment banks' concentration in the M&A sector gives birth to overlapping relationships which lead to a significant likelihood that any investment bank representing the acquirer would have had prior dealings with the target and as result, abuse of undisclosed information, material for the takeover, can occur to benefit the bidding party in the deal.
However relevant findings demonstrated that even if private information flows to the hostile bidder, it did not prove that the trade secrets may have affected the acquisition premia and that might have been shared by the investment bank[66].
The case studies examined confirmed these findings since both the lawsuits against Goldman Sachs and UBS involved respectively in the hostile takeover of Mannesmann and Dana Corporation were dismissed. The two advisors proved to have acted in the best interest of their clients and that the transmission of private information did not

[65] (McLaughlin, 1990)
[66] (Calomiris & Singer, 2004)

happen because of their procedures for protecting the confidentiality and their maximum transparency in doing business with competitors, in the full knowledge of their clients. The final goal of the investment bank is to maximize the shareholder value in advising its client companies on their deal. While the banker's advisory to target's executives on the anti-takeover strategies, poison pill and litigation, is able to boost the shareholder wealth through the maximization of the offer received[67], the bidder's banker does not produce higher returns compared to non-advised acquisitions even if a top-tier bank is hired[68]; moreover, the pursuance of a hostile takeover lead to a shareholder value disruption[69].

Generally, to launch a hostile bid, the unwanted suitor preliminary establishes a toehold in the company, by acquiring a portion of the target's ownership and publicly triggering the shareholders to tender their shares to consequently gain control over the company through the tender offer; It can also try to change the board of directors to hire new executives in favor to the change in control.

On the other side, the target company will structure defense strategies to prevent or deter the hostile bid. The most common techniques it can adopt have to do with the amendments in the corporate charter, the dilution of the shares of the bidder into the target firm, the costly remuneration of the top management upon the termination of their contract due to the takeover, the counterattack in buying the acquirer's shares, the lawsuit for misconduct and the strategic acquisition from a friendly third party. These and other methods are all used to make hugely expensive the takeover and to push the bidder in proposing a more attractive offer to appeal to the target's shareholders. The maximization of the acquisition premium is always preferred to the "Just say no".

[67] (Pearce & Robinson, 2004)
[68] (Servaes & Zenner, 1996)
[69] (Möhlmann, 2012)

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SUMMARY

Does the investment bank act for the target or the bidder's sake?
In the investment banking industry often occurs that the investment bank finds itself in a potential conflict of interest during hostile takeovers while it is acting as an advisor for its clients.
A hostile takeover occurs when the acquirer makes an attractive bid to buy and take control over the target firm by going directly to the target's shareholders, bypassing its management or the board of directors. If the board's members accept the offer, a due diligence process will be carried out and the offer will be announced. If they don't, the acquirer firm can structure hostile takeover tactics to finalize the deal directly with the shareholders of the target firm. The payment methods that can be used to take over the target firm refer to cash, stocks and/or other securities that the acquirer offers to the target's shareholders.
Hostile takeovers occur when the attacking firm senses that the target company is easy to take over because of some appearances in its capital structure, income stream, and market perception. Therefore, the plans of defense by the target are direct at reducing the value that the bidder can find in the firm. Normally, the value-enhancing characteristics in a target are:

- *High and steady cash flows*
- *Low debt levels*
- *Low stock price relative to the value of the firm's assets.*

Thus, the bidder searching for these features decides to launch a hostile tender offer.
How can the banker not fall into a conflict of interest if it advises client A while, at the same time, assisting client B in the hostile takeover of client A? And how can the banker be neutral after information about client A has been obtained and could be used to the advantage of client B in the hostile takeover of client A?

To understand the role of the investment bank in advising its bidder and target clients, a deep description and analysis have been conducted throughout the different strategies adopted by both parties to negotiate a takeover deal.
The hostile takeover tactics performed by the acquirer company to push for an attempted acquisition of the target company against the board's wishes could be divided into two categories depending on the time they are implemented. These are:

- *preliminary takeover steps*
- *takeover strategies*

The hostile bidder can structure preliminary takeover strategies to settle in advance its presence in the equity ownership of the target company, establishing in this way a toehold position, and to publicly trigger the shareholders to tender their shares, through the bear hug, to consequently gain control over the company. Then, takeover strategies are engaged in directly reaching the target's shareholders with a tender offer, that is an offer of takeover providing a notable premium to the current market value of the target. As an alternative takeover strategy, considering already the hostile bidder a shareholder of the target firm, there is the proxy fight or proxy contest. It deals with persuading the existing shareholders to vote out the management or the board members opposing the takeover to replace them with new board members who favourably accept the change in the ownership and therefore will vote in favour of the takeover.

The target firm, on the other hand, can put into play several defensive strategies to prevent or deter the hostile takeover bid by the unwanted suitor. The techniques adopted are used to make the takeover exorbitantly expensive. Therefore, the bidder firm either gives up on the hostile acquisition or raises the stake with an even larger acquisition premium to win the battle. Methods of resistance against a hostile takeover are divided into two groups:

- *Pre-offer defense*
- *Post-offer defense*

The pre-offer defense tactics are preventative anti-takeover measures aimed at preventing an unexpected hostile bid to take control over the target, giving it the time to erect or strengthen its defense. These involve amendments in the corporate charter by modifying the board's structure and classes with a Staggered board and the Dual class recapitalization, and by raising the majority threshold, making it harder and more expensive to reach the majority of voting rights by the hostile bidder with the introduction of the Supermajority and the Fair price amendments; the dilution of the acquirer's shareholding in the target company, in the case of a change in ownership, through the Poison pill by distributing to the target's shareholders the right to purchase shares of the target at a considerably reduced price. Thus, the potential acquirer would need to purchase more shares to reach the majority to gain control over the company, and this would discourage the takeover. The shareholder rights are inactive until they are triggered. A triggering event occurs when a tender offer is made for a large fraction of the firm, usually 30 percent; the Poison put, which is a covenant giving bondholders the right, but not the obligation, to redeem their bonds in case of an acquisition. As a result, if the takeover occurs, the new owner will be forced to instantaneously repay the outstanding debt if the bondholders exercise their right of early repayment before the bond's maturity date and this represents an added acquisition cost that the bidder must pay if it wants to take over the target firm; and the costly remuneration of the top management upon the termination of their contract due to the takeover, called Golden Parachute.

Post-offer defenses, instead, are used by the target company once it receives the hostile takeover bid by unwanted suitors. Unlike pre-bid defense strategies, the post-offer mechanisms are employed when the acquirer has approached the target firm and there is a real threat of a hostile takeover. These could be strategic operations concerning equity and debt, like, repurchasing stocks, thus reducing the number of shares that could

be purchased by the unwanted acquirer and rising the premium to be offered to buy the shares from the remaining shareholders; or, a leveraged recapitalization by changing the capital structure of the target firm in taking on significant new debt reducing the company's equity; these anti-takeover defenses also involve a leveraged buyout which is a going-private transaction involving a tender offer for all of a firm's common stock, financed mostly by debt, from the management; the share buybacks by the target company from the hostile bidder who has already acquired a significant number of shares in the target threatening a hostile takeover. The target company is forced to purchase its own shares at a considerable premium over the current market price to deter the unwanted takeover. This defensive strategy called Greenmail is often accompanied by an additional defense, which is the Standstill agreement, according to which the unwanted bidder undertakes not to acquire any more shares of the target company within a certain period of time; the sale of the most valuable assets, the crown jewels, of the target company to a favored third party at a discount to the market price or the spin-off of those assets into a separate entity, thus making the target less desirable for the bidder; the Pac-man defense which consists of the target's tender offer for the acquirer's shares, attempting a takeover of its own. The target company begins to buy up a controlling number of shares in the acquirer to gain control over it, just as the acquirer attempts to buy the majority of shares to obtain a controlling interest in the target. Therefore, the acquirer will give up on its attempt to take over the target if it is afraid of losing control over its own business; the welcoming acquisition of the target company by a friendly third party when the target firm is about to be taken over, called White knight, according to which the target company accepts the fact of being taken over since the white knight will offer to the target better takeover terms and a promise to keep the current management in place, preserve the company's core business and provide shareholders with enhanced value; the White squire, where the target company gives a friendly third party a certain amount of ownership in the target without acquiring it. The purpose of this mechanism is to buy just the number of shares of the target large enough to stop the hostile takeover and give the target company time to improve or change its defensive

strategy; filing a suit against the bidding firm for violating antitrust or securities regulations, thus litigation serves in delaying the bidder attack and therefore the target firms can benefit from receiving other offers thereby encouraging the competition between the bidders. The lawsuit will extend the negotiation period of time before the target company's board is required to reply to the bid. It also pushes the unwanted acquirer to raise the offer price to induce the target company to drop the suit and thus avoid paying for legal expenses; and in the end, the option of the "Just say no", which consists of just saying no to the negotiation of any deals and of refusing outright whatever bidders may offer. This approach enables the board to reject offers outright only if the target is engaged with the development and the application of a long-term corporate strategy such as a merger with a firm other than the one that has proposed the hostile bid.

The investment banks which operate alongside the parties in the deal, act in their best interests maximizing the value for their shareholders.
Servaes and Zenner (1996) demonstrated that the advisory services provided by the bankers to the acquiring company do not lead to higher returns for the shareholders compared to deals not advised. However, although several researchers by Golubov, Petmezas, & Travlos (2012) found that top-tier advisors help their clients to improve their acquisition performance, the reputation-quality mechanism remains inconclusive, and acquirers advised by top-tier advisors do not outperform those advised by non-top-tier advisors.
Moreover, the pursuance of a hostile takeover by the acquirer produces value creation for the shareholders in the long-run; despite those expectations, Möhlmann (2012) demonstrated that even if the hostile acquirer outperformed in a pre-takeover stage, the post-takeover brings negative profit returns, hence, shareholders' value for acquiring companies is destroyed by pursuing a hostile takeover. The reasons for the long-term shareholder value disruption lie in managerialism. Managers might have overestimated the value and the synergies related to the acquisition of the target firm by paying a too

high control premium; they may also have attempted to raise their wealth and personal status by buying control over large firms instead of optimally allocating resources and maximizing profit, or even, they may have wanted to reduce their chance of being acquired by acquiring another firm and thus increasing the size of their own firm.

For the target firm, the investment bank is fundamental in its role of advisor for which it is asked to review the financial adequacy and fairness of the bid and to obtain details on the financial and monetary stability of the bidder. More important, it advises the executives on the most powerful defensive strategies to adopt to avoid a hostile takeover in the best interest of the company and to better maximize the target's shareholder value. Pearce & Robinson (2004) proved that when executives support a poison pill provision to repeal a hostile attack or encourage litigation to extend the negotiation period between the two companies, the defense is likely to boost shareholder wealth.

In its advising role, the investment bank should act in the interests of its clients. A potential conflict between the interests of the bidder and those of the target arose when the banker advises or advised in the past client A and assist client B in the hostile takeover of client A. Usually, corporate clients choose to hire investment banks with more experience, capital and information. Not all investment banks are able to take on large deals, especially the smaller ones, therefore, those entitled to advising on significant projects will tend to merge with each other to obtain more capital and share the risk. They create a sort of syndicate and advise all together the same client on very large transactions such as a takeover. In this way, if the deal collapses, the associated risk is shared across multiple banks. This gives birth to concentration in the M&A sector. Hence, an investment bank that advised client A in the past may now assist client B in the hostile takeover of client A and this is because the investment bank that has been hired by client B, was part of the syndicate which advised client A on its prior dealings. This is the case in which the potential conflict of interest can rise. When this happens, the private information collected by the banker from one corporation to pursue its own interest might be then shared with the bidder client in carrying out a divergent deal against the target client. Although such overlapping relationships do not constitute

a breach by the investment bank, it violates the law if the banker exploits the knowledge of sizeable undisclosed data about a company to advantage the opposite party in the deal. Thus, if the considerable and strategic information about client A, that are material to the takeover, is transmitted to client B, this could affect the acquisition premium client B is willing to pay for the takeover of client A. It follows that the public revelation of this important information may significantly affect the abnormal returns of the stock price of client A.

However, Calomiris & Singer (2004) demonstrated that even if private information flows to the hostile bidder, it did not prove that the trade secrets may have affected the acquisition premia and that might have been shared by the investment bank.

Building a Chinese wall and/or including a written agreement on disclosure in merger contracts can be a possible way out of potential conflicts of interest.

The Chinese wall describes a virtual barrier used to block the exchange of information inside the financial institution giving clients the discretion on their private information. The Chinese wall policies can be used by the investment bank to self-regulate their business dealings by generating ethical boundaries between the different departments or project teams to prevent the sharing of non-public information provided by clients that might lead to ethical or legal violations. There is a conflict of interest during a hostile takeover once the private information, that is material to the takeover, breaches the Chinese wall and, consequently, the public revelation of that information affects the abnormal returns of the target's stock price.

A written agreement on disclosure should be required by the client who hires the investment bank for advisory services; it is at the description of the client to obtain the assurance about disclosure if it is afraid that revealing such material secret information about its business to the investment bank could be of interest to a competitor. There may be a potential conflict of interest if the client does not ask for a written agreement about disclosure before providing private information, but it is conditional on such agreements being secured, the investment bank's responsibility to protect confidential information.

Going further in the relationship between the investment bank and the parties in a hostile takeover and its actions either for the target or for the bidder's sake, the agency theory and the dual role advisory, highlight and explain the contrasting interests on the ground. The executives of both target and bidder firms often rely on investment banks to be advised on mergers and acquisitions transactions to improve the efficiency and the effectiveness of the negotiations, hence, in an agent-principal relationship, the investment bank, which represents the party in a deal, acts as the agent while the firm involved in the operation act as the principal. It may occur that the interests of the agent and those of the principal are at odds and thus the advice of the investment bank may not be in the best interests of the client; an agency problem might occur if the banker, who operates on behalf of the target or the bidder firm, seeks to gain from the deal by pursuing its own goals. McLaughlin (1990) said that the fees paid to bankers are typically a percentage of the total value of a deal, therefore, the investment bankers of both target and bidder benefit more from higher premiums. However, the bidder's goal of minimizing the premiums paid conflicts with its bankers' objective of maximizing fees, while for the target, the interest of maximizing the premium is in line with the banker's objective. The result is that the potential agency problem arises between the hostile bidder and its investment bank.
Analyzing, instead, the dual role advisory of the investment bank when it advises the target and, at the same time, finances the bidder for the takeover, the conflict of interest arises between the target and its banker because the latter's advice is skewed by the profit it may gain by financing the bidder.
The two case studies examined in the paper point out the consequences suffered by the investment bank for being in a potential conflict of interest between its bidder and target clients. The charge of transmission of private information of the target firm by the investment banks at issue, Goldman Sachs and UBS advising respectively the hostile takeover of Mannesmann and Dana Corporation, to the hostile bidder, resulted to be groundless and did not affect the outcome of the deal. The lawsuits against them were dismissed by the court.

On 13 November 1999, the British telecommunications company Vodafone Airtouch PLC. announced a takeover bid for the German telecommunications and engineering group Mannesmann AG. Goldman Sachs was hired by Vodafone to launch the hostile tender offer against Mannesmann. Vodafone and Mannesmann were publicly considered coalition partners till November 1999. After the takeover of Airtouch, an American wireless telephone service provider, Vodafone became a market leader as a mobile telecommunications provider and shared with Mannesmann joint participation in E-Plus, a mobile telecommunications operator in Germany recently taken over by Telefónica Germany. Moreover, Vodafone came to control almost 35.0% of Mannesmann Mobilefunk, previously held by Airtouch, giving it a toehold in the takeover bid.

In the meantime, in October 1999 Mannesmann made a takeover bid for Orange, a British mobile network operator and internet service provider, which threatened Vodafone's home market and triggered it to launch a takeover offer to acquire Mannesmann. Indeed, on November 14 a friendly merger bid was made.

Mannesmann's board of directors decided to reject the friendly tender offer by Vodafone on November 19 because the proposal was apparently inferior compared to the value of the company.

In December 1999, Vodafone come forward with a new offer directly proposed to the Mannesmann shareholders to exchange their share in the ratio of 53.7 Vodafone AirTouch shares for 1 Mannesmann share, as a pure swap with no cash component. With this unsolicited takeover bid, the battle started.

In November 1999 the CEO of Mannesmann, Klaus Esser required that Goldman Sachs should stop advising Vodafone. Since Goldman Sachs had advised Orange in its friendly merger with Mannesmann, Esser argued that Goldman Sachs had access to private information. As a result, Goldman Sachs temporarily ceased its consulting activity. Meanwhile, Mannesmann filed a petition at the High Court in London to have Goldman Sachs suspended from acting as a consultant. Goldman Sachs defended itself by

asserting that it would not have acted for bidders on a hostile takeover for an existing client but it might have acted against a former client consistently with any obligation of confidence owed to former clients. The suit was refused because it was found out that Goldman Sachs wasn't in possession of confidential information from its past involvement with Mannesmann dropping the charges by Esser who accused the investment bank of conflict of interests.

Dana Corporation, an American automobile equipment manufacturer, retained UBS to negotiate a potential joint venture between Dana Corporation and Chrysler. UBS assisted ArvinMeritor, an American automobile components manufacturer, in its hostile takeover attempt of Dana Corporation.

UBS was hired by ArvinMeritor while it was representing Dana Corporation in the joint venture between Dana and Chrysler, involving Detroit axle, an axle production facility. During the representation of Dana, UBS obtained material private information that if shared with ArvinMeritor, would have advantaged its hostile takeover attempt because they were of great value and importance to ArvinMeritor in planning and executing its takeover strategy. In 2003, shortly after the announcement of ArvinMeritor's hostile takeover attempt, Dana Corporation filed a lawsuit in the United State District Court in Manhattan, New York, against UBS, to prevent it from acting as an adviser.

In the lawsuit, Dana Corp accused UBS of abuse of substantial amounts of confidential information it gained from having advised Dana on a significant corporate project and to have acted without any disclosure to Dana. UBS defended itself against charges by asserting that it was committed to the highest standard of professionalism and ethics and has adopted the appropriate compliance procedures to prevent any breach of client confidentiality. It went on to say that its public relationship with ArvinMeritor began prior to its engagement by Dana; and, at the time it engaged UBS, Dana acknowledged the potential for UBS to do business with competitors and its procedures for protecting confidentiality.

Calomiris & Singer (2004) studied the Dana Corporation case and run an economic test for the materiality of private information. They analyzed Dana's abnormal returns surroundings the announcements about the joint venture. If the joint venture had been material to the takeover, its announcement would have affected the current share price of Dana Corp. This because ArvinMeritor could have offered a premium for the acquisition sufficiently high to appeal to the shareholders, knowing that there was an important transaction going on that would have increased the market value of the target company.

The study of the impact of these events on Dana's stock price reveals that the market did not perceive the planned joint venture to be material to the success of the takeover by ArvinMeritor, or to the price at which such a takeover would have taken place.

The court dismissed the case.