All That Glitters Is Not Gold: Mergers and Acquisitions

APRIL 25, 2023

Download a PDF Below: (/s/Guillen-Note.pdf)

All That Glitters Is Not Gold: Mergers and Acquisitions

Amanda Guillen ***[1]***

The office of the scholar is to cheer, to raise, and to guide men by showing them facts amidst appearances. ***[2]***

Introduction

In 2021, "the overall value of Mergers and Acquisitions ("M&A") stood at $5.8 trillion," an increase of 64% from 2020.[2] Not only did 2021 have a scorching increase from the prior year, but the sheer dollar amount of $5.8 trillion of M&A activity is worth mentioning as well. $5.8 trillion is the equivalent to the market value of Apple ($3 trillion), Microsoft ($2.5 trillion), and Disney ($0.3 trillion) combined.[3] With the headwinds faced moving into 2022, such as inflation, rising cost of capital, supply chain issues with Ukraine, and geopolitical tensions from US-China[4]… 2022 will still likely reach $4.7 trillion in deal value by year-end, which would make it one of the strongest markets of the past *20 years.*

"Firms engage in mergers because they see a profitable opportunity."[5] If a firm can purchase another company in the hopes of reducing costs, "the result can be lower prices for consumers and improved overall economic welfare."[6] This is just one example of how a firm can meet the goal of a profitable opportunity. One of the most significant mergers that impact life today is the growth of the American Telephone and Telegraph (AT&T).[7] In 1883, AT&T "adopted a strategy of merging local telephone companies into a national system.[8] The resulting network reduced the costs of interconnecting large numbers of users, and the telephone quickly replaced the telegraph as the communications technology of choice."[9] Ultimately generating long-term value for shareholders, who provide the capital that allows companies to invest, and innovate, is a fundamental reason for firms engaging in a merger.[10] Bringing us back to present day, with the trending highest volume of M&A activity in history… is this activity still generating value for shareholders?

It is too early to tell if the flurry of activity from 2021 to 2022 will lead to successful business outcomes. However, data for previous years' M&A activity is available.[11] Per Harvard Business Review, typically "70%-90% of acquisitions are abysmal failures."[12] Failure is the state or condition of not meeting a desirable or intended objective and may be viewed as the opposite of success[13]—and it seems a bit harsh to put M&A activity in that category. Because failure may seem fatal, as if it is impossible to climb out of this state of failure. But failure is not fatal. The failure to recognize *change* to meet the intended objective is fatal.

This Note begins in Part I with an overview of M&A. This section discusses the original goal of M&A which is to maximize shareholder value. In theory, the shareholder wealth maximization norm[14] is the north star that guides business executives and the law. The shareholder wealth maximation norm sets the intended objective as—the pursuit of increasing share price maximizes the wealth of actual shareholders.[15] Moreover, Part I sets the stage for what is a corporation and M&A. In Part II, this section builds on a case study of recent M&A transactions. Further, this Part goes into the factors that may contribute to challenges seen in M&A. In Part III, this Part proposes using earnout provisions in M&A contracts as a solution for leaders to implement.

I. The Measure for Successful M&A—Shareholder Wealth Maximization

U.S. Corporate law gives control of the corporation in the board of directors and those executives to whom the board properly delegates decision-making authority.[16] The discretionary powers conferred on directors and officers, are to be directed towards a single end; the maximization of shareholder wealth.[17] "Shareholder wealth maximization long has been the fundamental norm which guides U.S. corporate decisionmakers."[18] In the landmark Michigan Supreme Court case *Dodge v. Ford Motor, Co.*:

> A business corporation is organized and carried on primarily for the *profit of the stockholders.* The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means *to attain that end*, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[19]

"The shareholder wealth maximization norm exerts tremendous influence on both business practice and corporate legal scholarship."[20] Per *eBay Domestic Holdings, Inc.*, corporate management is legally required to pursue profit; it must also seek to maximize the shareholders' financial interests.[21] As such, publicly traded companies place great importance on their stock share price, which reflects a corporation's overall financial health. The higher a stock price is, the more ideal a company's prospects are. The norm and the related focus on share prices rest on two key assumptions: (1) that the pursuit of shareholder wealth maximization, as measured by share price, effectively maximizes the wealth of actual shareholders and (2) that the pursuit of shareholder wealth maximization, as measured by share price, is socially beneficial.[22] If the share price is not increasing, then the practice should be to change course.

With the proliferation of M&A activity in recent years, it would be safe to assume that share prices are also increasing. But is all this huge influx of M&A activity providing increased shareholder value or is all that glitters is not gold?

A. Background

A corporation is a legal entity.[23] One of the main advantages of a corporation is the benefit of centralized management.[24] Shareholders elect a corporation's directors, who have the power to manage and oversee the corporation's business.[25] Shareholders play only a limited governance role, in part because the directors have fiduciary duties to act in the best interests of the corporation.[26] The directors typically delegate responsibility for daily decisions to corporate officers.[27] The separation between shareholder ownership and managerial control is one of the distinctive features of modern corporations.[28]

Centralized management has allowed individuals to partake in a comparative advantage. Comparative advantages describe a situation in which an individual can produce a service at a lower opportunity cost than another.[29] Here, a shareholder elects a corporation's directors so that they can best utilize their time as they see fit. The corporation's directors produce a more significant financial benefit in the best interests of the corporation. In theory, the corporation's directors manage a corporation at a lower opportunity cost, compared to an individual shareholder given their knowledge and expertise.

While a corporation has many advantages, there are also corresponding disadvantages—agency issues. The corporation, a legal construct, can act only through the agency of human beings.[30] Agency is a consensual relationship between two parties, the "principal" and the "agent."[31] The principal selects the agent, who agrees to act on the principal's behalf and subject to the principal's control.[32]

In regard to mergers and acquisitions, agency implications could be value destroying when managers engage in opportunistic acquisition reasons for self-interest.[33] Empire building motives, managerial myopia, overconfidence, misaligned incentives, and poor corporate governance can all exacerbate the agency problem.[34] For example, there are various ways that managers can build empires so as to increase the size of their firm, also known as their sphere of control.[35] When managers have larger companies to manage, they are seen as having more power.[36] Managers' empire building incentives can also be related to their compensation packages, which are often tied to a larger firm size measured by its combined market value.[37] Therefore, mergers and acquisitions are often considered a good candidate for rapidly and effectively increasing firm size.[38] Studies also show that where managerial compensation is based on the acquisition of profits, with no emphasis on long-term incentives, that this would provide managers with perverse incentives to acquire companies so as to increase the size of their firm, despite ultimately leading to deterioration in shareholder value.[39]

Another issue between "agents" and "principals" are misuse of resources. "Agents" can use their position to divert the corporation's funds towards initiatives that the "agent" personally wants to achieve. Breaching fiduciary duties[40], a manager could have the desire to acquire a company as a "pet project," which may have diminishing returns.[41] The desire to acquire this "pet project" company would devote millions, potentially billions of dollars of financial and human resources that belong to the corporation, but in essence, funds that belong to the shareholders. For example, AOL's CEO hatched Patch in 2007 while an executive at Google, then convinced AOL to purchase Patch after he took over in 2009.[42] AOL shareholders felt the CEO cling to Patch with a blind paternal love.[43] Over five years, Patch is estimated to cost AOL between $200 million and $300 million to run.[44] "It is easy to see how an agent, having the power to exercise control over assets belonging to the principal, may be tempted to use those assets in a way that benefits the agent's ego".[45]

This challenge between "agents" and "principals," it might seem as though the ability to maximize value may never be achieved.[46] Even with the agency issues, the ability to maximize value *has* been achieved—historically, the stock market has provided around 6% of annual returns over the long term.[47] For most Americans, 6% sounds pretty good. And for most Americans, how much they have to invest is singularly a function of how much they can make from their labor. The American people who owe almost all their wealth to their ability to hold a job and to secure gains in wages—"is true for 99% of Americans".[48] After putting in a minimum 40 hours of work a week, the fruits of American labor are spent on a house and car payment, student loans, wedding debt, and the leftover cash is put towards a new air conditioner or an on-call plumber. The remainder is invested in a 401(k) plan where the funds are out of reach until the investor reaches the age fifty-nine and a half.[49] It is not a surprise that "...nearly half of all working-age families have zero retirement savings..."[50] For these reasons, it makes sense to question whether this hard-earned money is earning the biggest bang for your buck. If these agency issues were nailed down, could the new normal average returns be 12% or 24%? The sky is the limit.

B. M&A

M&A involves the buying and selling of corporations.[51] M&A deals are done from the direction of executives, "who also largely run the deal-making process".[52] The acquiring company is called the "bidder" or "acquirer". The "target" is the company that is about to be acquired. Historically, the United States has had a relatively pro takeover regulatory environment.[53]

With the general economic outlook relatively stable, executive confidence is at an all-time high to pursue acquisitions they have long considered.[54] "Management teams have been dusting off corporate playbooks for potential deals"[55] and to do—acquire companies—than do not. Based on the converging factors, dealmakers find themselves in a sweet spot between the optimism of the market and the bountiful economic landscape. M&A will continue as a central feature of the global corporate landscape. But, the question still remains whether the flurry of activity continues to increase shareholder wealth.[56]

II. Analysis

This Part examines why M&A activity may not be as valuable as initially intended—increasing shareholder wealth. The first Section discusses M&A impact on shareholder prices by case studies. The second Section discusses inherent finance and legal challenges inherent in M&A deals.

A. Profitability Analysis of Companies Engaging in M&A

Many scholars have examined the impact of M&A and whether there have been profitable results. In theory, these studies have inherently had several limitations. The main limitation is truly understanding the *source* of merger gains or losses and gathering this data systematically across companies in similar industries, sizes, and goals. The challenge is clearly correlating that M&A activity is the *source* of increased share price or if there are other factors involved. Perhaps there could be a new marketing scheme that propelled the stock price, or a competitor left the industry, in which both instances could increase the share price—neither having to do with increased M&A activity. Correspondingly, the reverse is true. Companies could neglect their marketing teams and a competitor enter the market, causing cause share price to decrease—again, these activities would have nothing to do with M&A activity. Because of the difficulty of acquiring the necessary data, scholars have typically taken a case study approach, examining a few mergers within the same of comparable industries.[57]

Studies have been completed over the years conveying evidence that mergers cut deep into the financial red. In general, many large-scale acquisitions of public companies by other public companies result in significant losses for shareholders of acquiring firms.[58] Not only do bidder shareholders lose, but the losses from these deals can be staggering.[59] For example, a study of deals from 1998 to 2001, finds that bidder shareholders lost 12% for every dollar spent on acquisitions, for a total of $240 billion.[60] A study on law firm mergers performed analysis to contradict the conventional wisdom that mergers enhance profitability through increased revenues and reduced costs.[61] The study showed that law firms post-merger revenues were lower relative to competitor firms that than the sum of predecessor firms' revenues, and cost per lawyer increase markedly.[62] Further, a study of Asian bank mergers found no observable efficiency effects.[63] Another example in the electric power industry, evidence suggests there are no net efficiency gains from M&A.[64] Ultimately, a significant body of recent finance literature finds evidence that many, although not all, acquisitions destroy value for long-term [Bidder] shareholders.[65]

In contrast, there is data showing that mergers suggest that there are efficiency gains. One review suggests that efficiency gains predominated in North American and European bank mergers.[66] Another study reviewed forty-nine studies and found that nearly three-quarters of them showed mergers resulted in price increases.[67] In 2016, Bruce Blonigen and Justin Pierce studied U.S. manufacturing industries that covered companies from the timber to electronics to printing services.[68] Blonigen's and Pierce's research demonstrated that the average merger increased market power.[69] These studies contradict the initial case study on companies in the healthcare industry.

Overall, the infamous lawyerly response to whether mergers increase or decrease shareholder value is—it depends. It depends various circumstances that vary according to market composition, industry, geographic location,[70] economics, and available data. Evidence supports each view and the effects of mergers remain in dispute.[71] The idiosyncrasies of the specific companies and sectors limit the ability to generalize the data.[72] Evidence exists that routinely show stock market event studies that find shareholder gains from mergers, at least in the short term.[73] On the other hand, there are studies of actual operating effects that tend to show that gains from mergers are the exception rather than the rule.[74] The best example of the ambivalent results is an economist who attempted to study the effects of all mergers in the world occurring over fifteen years.[75] The result of the study found that only 29.1% of mergers appear to result in efficiency gains, with approximately the same number actually reducing efficiency.[76]

Although the data can be inconclusive as to whether mergers increase or decrease share price, it is important to recognize that the conventional wisdom that mergers enhance profitability should *not* be assumed.

B. Legal and Finance

This section assesses the factors that may have an impact on shareholder returns for M&A: Legal and Finance.

i. Legal—Limited Liability for failed M&A Transactions

In 2015, Microsoft wrote off 96% of the value of the handset business it had acquired from Nokia for $7.9 billion the previous year.[77] If an executive were forced to clear out $7.9 billion from their savings account for a failed business acquisition, would the executive have purchased it in the first place? Likely, not. Instead, the present law shields decision-makers from a potential liability through the business judgment rule leaving shareholders, who are—besides employees—typically harmed the most by failed M&A transactions, largely unprotected.[78] Directors of public corporations are seldom held personally liable for their decision making.[79]

As part of the common law for at least one hundred and fifty years, the business judgment rule protects directors from liability for business decisions, even those that were ill-chosen and resulted in losses to the corporation.[80] In *Wrigley,* the Chicago Cubs' president refused to install field lights for night games at Wrigley Field against the wishes of a shareholder.[81] The shareholder claimed that because the president refused to install field lights for night games leading to lower profits for shareholders.[82] The court held that the judgment of the directors of the corporation enjoys the benefit of a presumption that it was formed in good faith and was designed to promote the best interests of the corporation they serve.[83] If the decisions are within the "realm of reason," it generally will be protected.[84]

The underlying consideration behind the business judgment rule is that the courts' role is inherently different than a business decisionmaker for a variety of reasons. For example, a judge deciding on a decision after the fact is plagued with hindsight bias.[85] Thus, judges tend to be ill-equipped for reliably second-guessing the quality of business decisions.[86] Additionally, substantive judicial review of business decisions would require significant resources.[87] As a manager in Corporate America, imagine if every time a poor decision was made, the courts were looming close by, reprimanding every step. The business judgment rule expresses a balance between embracing economic freedom and informed risk-taking.[88] It presumes the benefits from entrepreneurial risk-taking exceeds the cost resulting from wrong business decisions.[89] Essentially, the business decision makers at Microsoft, although writing off $7.9 billion in 2015, have led to revenue *growth* of $800 billion in three years.[90]

Despite the risks that directors and officers contribute to the failure of M&A transactions, they cannot be held liable under current law. The courts understand that there is no reward with no risk and, as such, shareholders can be rewarded nicely or inadequately. The business judgment rule protects directors and officers from liability which effectually makes acquiring companies a "win-win" because there is minimal risk to the directors but a maximum reward to shareholders.

ii. Finance— 2+2 = 5?

This section begins with the following observation made by an experienced M&A lawyer:

> A major merger or acquisition can be a company-defining moment. The right business combination at the right price, with good execution, can reposition the company, accelerate growth and shareholder return, and even change the game for an industry. But a bad deal—whether the failure is rooted in the concept [i.e., the "logic of the deal," that is, the business justification for the proposed acquisition], the price, or the execution—is probably the *fastest legal means of destroying shareholder value.****[91]***

Thus, in order to create shareholder value, the acquirer must purchase the target for a fair price.[92] When an acquirer overpays for a target, spending resources on trying to meet unattainable financial goals can be unsalvageable. If each company A and B is worth $2, then after the merger transaction, per the shareholder wealth maximization theory, it should be worth $5. If A purchases B for $2.5, but the benefits fail to materialize over several years, this acquisition is doomed for failure. Because each year is spent trying to climb out of the financial hole it initially dug itself in. However, zealous business executives continue to search for profitable opportunities in the hopes of increasing shareholder value. But all too often, as seen in the popular press,[93] bidder overpayment and poorly performing corporate acquisitions strike out.

An example is when Hewlett Packard ("HP") purchased a British company, Autonomy, for $10.3 billion—a decision that was controversial with HP shareholders who claimed HP was overpaying for Autonomy.[94] A year later, HP announced a write-down of $8.8 billion related to the acquisition due to accounting irregularities.[95] HP was unable to realize the gains it expected from the acquisition.[96] Not only was there no added benefit to the acquisition, but the cherry on top was a large securities class action suit.[97]

A crucial component that can lead to the success of an M&A transaction begins at the initial due diligence. Due diligence is a thorough analysis and investigation of the target company.[98] A company usually has a corporate development team that provides decision-makers with financial information and assesses the risk and opportunities of engaging in a M&A transaction. Besides risk assessment and valuation, it typically prepares for the composition of the contractual representations and warranties[99] and assesses whether the target company is a profitable opportunity. In complete secrecy, the target provides information to the acquirer about the business, finances, tax, legal, and human resources.[100] Due to the small window for providing this information, acquirer decision-makers rarely receive the information they need to make an informed decision from the target. Additionally, another challenge for the acquirer is the mass of information that would need to be digested in a short timeline to make a well-informed decision, not to mention ensuring that the *right* questions are asked of the target.

After collecting information in the due diligence phase, the acquirer uses this information to make a well-informed purchase price for the target. One of the most common methods to assess the value of a company is the discounted cash flow (DCF).[101] DCF models rely on estimates and discounting all future cash flows to determine net present value.[102] The offer amount largely depends on the quality and extent of the available data.[103] The models use assumptions provided by the target and market data to form a purchase price.[104] The assumptions are the greatest weakness in valuation models because essentially these assumptions predict the future[105]—something that is very challenging to do.

With a mix of time pressures and assumptions to value the target, this could lead to negative financial consequences in which the acquirer overpays for the target.[106] With the legal and financial challenges at play in an M&A transaction, is there a potential solution for management to engage?

III. An Opportunity for More Shareholder Wealth—A Call to Action

Part III reflects on the challenges discussed in Part II and provides a solutions to the legal and financial challenges presented, by using earnout provisions to align compensation incentives.

As shadows cannot exist without light, the corporation's advantage of a centralized management cannot exist without agency issues.[107] In M&A deals, executive compensation is generally issued for "closing the deal"[108] rather than the financial success of the deal which can often take years. On average, about a quarter of executives in acquired top management teams leave within the first year, a departure rate about three times higher than in comparable companies that haven't been acquired.[109] An additional 15% depart in the second year, roughly double the normal turnover rate.[110] All too often, after the close of the deal, target executives are either mentally out the door or forcibly ushered out the door by the acquirer. Target executives leave voluntarily after an acquisition for a variety of reasons. A couple of reasons are that target CEOs receive golden parachutes at the time the merger is approved, [111] need a break, or don't feel needed in the new company.[112] Limited liability, as discussed in Part II, could be a hindrance to shareholder profitability when combined with executives that have no skin in the game.

During the deal negotiation between the acquirer and target, an earnout provision can create incentives that encourage management to stay after the acquisition. An earnout provision is a contractual payment mechanism in M&A where a relatively large part (often around a third) of the deal consideration is deferred and payable at multiple stages, contingent upon observable measures of the target firm's future performance.[113] Another benefit of an earnout provision is that it provides continuity for the success after the acquisition. Target leaders can guide the integration of the two companies, rather than leaving abruptly after the close of the transaction. Instead of incentivizing target executives to successfully *complete* the transaction, the acquirer can negotiate incentives tied to the future success of the integration of the two companies.

An earnout provision emphasizes more skin in the game when it comes to spending the corporations, or shareholders', assets for an acquisition. Target managers are motivated to remain in the firm and maximize its performance (to receive the deferred payments).[114] Studies convey that earnouts reduce the underlying valuation gap between the merging firms by explicitly linking the target firm's payment in the acquisition to its future performance.[115] This, in turn, is associated with an increased overall likelihood of merger success (and higher merger synergies).[116] Additionally, the findings suggest higher acquirer gains relative to counterpart M&As without earnouts.[117]

The financial blinders of overpaying for a company[118] can be reduced when earnout provisions are introduced. The leaders of the target corporation will be incentivized to integrate the two companies successfully when their bonus is tied to completion milestones. Integration is the phase after the transaction closes where employees from the target and acquirer work together to combine the companies. The integration involves constant and cross-communication between all functions in the target and acquirer corporation—legal, human resources, finance, information technology, R&D, and more. The integration phase is a people-intensive activity, and the corporation cannot have a successful conclusion unless they are fully sourced and managed by empowered leaders.

So, why is it that only 27% of companies utilize an earnout provision?[119] It is quite risky for the acquirer and target—it represents real dollars.[120] An earnout provision could result in the acquirer paying more for the target than the buyer may have originally intended to pay.[121] Additionally, the buyer and seller are at risk for litigation when it comes to the earnout formulae for the acquired business, leading to more expenses.[122] For example, the allocation of overheard costs is a common challenge.[123] Or consider potential disputes over what numbers are included in financial metrics to earn the earnout bonus. Further, goals may not be aligned.[124] For instance, the target's management may be motivated to maximize earn-out payments, but not necessarily to advance the buyer's business strategy or interests.[125]

Unfortunately, earnout provisions are often heavily negotiated and fact specific.[126] In 2013 to 2019, the percentage of transactions with earnouts have been 25% to 27%.[127] This is a steep decline from the upward trend in 2007 to 2011, where the percentage of transactions with earnouts increased from 19% to 38%, respectively.[128] An earnout forces the parties to think about the future, which is a good thing.[129] But, the earnout also keeps an acquisition attorney asleep with one eye open because of the possible dreary outcomes. Lawyers negotiating earnouts on behalf of their clients must have a keen eye for the relative risks and rewards of earnout provisions. As a result, the inclusion of earnout provisions in M&A tends to be the exception rather than the rule.[130] However, using an earnout provision is a tool to provide leadership a tangible action toward climbing an upward mountain of improving insatiable shareholder growth.

Conclusion

This Note uses M&A activity as a lens to examine the shareholder wealth maximization norm. Part I provides the background on corporate M&A and the shareholder wealth maximization norm. Part II examines case studies on M&A activity and trends in share price, and some of the financial and legal reasons for some lackluster deals. Part III provides tangible solutions to improve shareholder wealth—earnout provisions. Overall, this Note reveals that the traditional shareholder wealth maximization is limited and problematic. This Note does not attempt to prove that M&A activity does not further shareholder wealth. But instead, whether shareholders could benefit from leadership decisions that execute on the plans they initially intended. If shareholders *are* receiving a benefit from M&A activity, could shareholders be receiving *more* of a benefit?

When AT&T merged with local telephone companies into a national system, the company changed America and, more importantly, the world. The ability to receive and send instant communication in this day has propelled our society to a new level of efficiency. Although 1883 was a much simpler time with less globalization and fewer legal rules, one thing remains the same: creating value for shareholders. M&A should be more than just romantic; it should produce a more efficient and valuable product. The idea that M&A could be just romantic rather than real begs the question—is M&A providing a real benefit to shareholders? If not, how can we make it better? Or is M&A activity capped at maximum efficiency?

For now, the law recognizes shareholder wealth maximization as the only game in town.[131] It is not about to change.[132] Further research could persuade leaders, lawyers, and all those involved with M&A—to do the right thing—for the benefit of shareholders. If these questions are not asked, shareholders will bear the brunt of the loss.

[I] J.D. & M.B.A. Candidate 2023, University of Kentucky J. David Rosenberg College of Law; B.B.A. 2012, University of Texas at Austin, McCombs School of Business. Grateful for the support from my husband Roy Guillen. Special thanks to Professor Alan Kluegel, PhD for guidance and comments.

[1] Ralph Waldo Emerson, *The American Scholar*, *in* Ralph Waldo Emerson Essays & Lectures 51, 63 (Joel Porte ed., 1983).

[2] Niket Nishant, *Global M&A Volumes Hit Record High in 2021, Breach $5 Trillion For First Time*, Reuters (Dec. 31, 2021, 12:44 AM), https://www.reuters.com/markets/us/global-ma-volumes-hit-record-high-2021-breach-5-trillion-first-time-2021-12-31/ [perma.cc/J79F-L4W6 (https://perma.cc/J79F-L4W6)].

[3] Jack Nickas, *Apple Becomes First Company to Hit $3 Trillion Market Value*, New York Times (Jan. 3, 2022), https://www.nytimes.com/2022/01/03/technology/apple-3-trillion-market-value.html.

[4] Les Baird, David Harding, Suzanne Kumar & Andrei Vorobyov, *Global M&A Report Midyear 2022*, Bain & Co. (Jul. 7, 2022), https://www.bain.com/insights/global-m-and-a-report-midyear-2022/ (https://www.bain.com/insights/global-m-and-a-report-midyear-2022/) [https://perma.cc/9ZZ9-CK5X].

[5] Bruce A. Blonigen & Justin R. Pierce, *Mergers May Be Profitable, But Are They Good For The Economy?*, Harvard Business Review (Nov. 15, 2016), https://hbr.org/2016/11/mergers-may-be-profitable-but-are-they-good-for-the-economy [**https://perma.cc/7BUJ-AXYD**].

[6] *Id.*

[7] David Besanko, David Dranove, Mark Shanley & Scott Schaefer, Economics of Strategy 107 (5th ed. 2010).

[8] *Id.*

[9] *Id.*

[10] Statement on the Purpose of a Corporation, Bus. Roundtable (Aug. 19, 2019).

[11] Roger L. Martin, *M&A: The One Thing You Need to Get Right*, Harvard Bus. Rev. (June 2016), https://hbr.org/2016/06/ma-the-one-thing-you-need-to-get-right [**https://perma.cc/PC7G-M54V**].

[12] *Id.*

[13] *Failure*, Merriam Webster (1st ed. 2016).

[14] *Infra* note 15—note 21.

[15] *See generally* Caleb N. Griffin, *The Hidden Cost of M&A*, 48 Tex. J. Bus. L. at 71 (2019).

[16] *See, e.g.,* Del. Code Ann. Tit. 8, 141(a) (2001) (the corporation's business and affairs "shall be managed by or under the direction of a board of directions"). All state corporate codes likewise provide for a system of nearly absolute delegation of power to the board of directors, which in turn is authorized to further delegate power to subordinate firm agents. *See* Model Bus. Corp. Act Ann. 8.01 cmt. (1995) (reviewing statutes).

[17] *See* Infra note 15 and accompanying text; *See* supra note 18.

[18] Stephen M. Bainbridge, *In Defense of The Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 Wash. & Lee L. Rev. 1423, 1423 (1993); Stephen M. Bainbridge, Corporate Law 141 (2d ed. 2009) ("It is well-settled that directors have a duty to maximize shareholder wealth." (citing *Dodge* for the assertion that corporations should have a "profit-maximizing purpose").

[19] Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (emphasis added); *See, e.g.,* Katz v. Oak Indus. Inc., 508 A.2d 873, 879 (Del. Ch. 1986) (suggests that directors have a duty to maximize shareholder value).

[20] Griffin, *supra* note 15, at 71.

[21] *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010); Lyman Johnson & David Millon, Corporate Law after Hobby Lobby, 70 Bus. Law. 1, 10 (2014).

[22] *Id.*

[23] Alan Palmiter, Frank Partnoy & Elizabeth Pollman, Business Organizations: A Contemporary Approach 74 (3rd ed. 2019).

[24] *See id.* at 77.

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.*

[29] *See* James A. Brickley, Clifford W. Smith, & Jerold L. Zimmerman, Managerial Economics and Organizational Structure 64 (5th ed. 2009). Comparative Advantage is generally used in terms of goods. In advanced economies, individuals specialize in producing goods where they have a comparative advantage; they then trade to acquire other goods. Specialization enhances the standard of living of a society.

[30] Palmiter, *supra* note 23, at 220.

[31] Restatement (Third) of Agency § 1.01 (2006); Palmiter, *supra* note 23, at 903.

[32] *Id.*

[33] Scott Fung, Hoje Jo, Shih-Chuan Tsai, *Agency Problems In Stock Market-Driven Acquisitions*, Emerald Insight, (Oct. 30, 2009) https://www.emerald.com/insight/content/doi/10.1108/14757700911006958/full/html.

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] *Id.*

[40] Palmiter, *supra* note 23, at 22. "Fiduciary duties seek to protect those who delegate authority against the negligence, disloyalty, or worse of those who exercise this authority on their behalf."

[41] Net present value is the present value of cash flows at the required rate of return of your project compared to your initial investment. In practical terms, it is a financial metric used to evaluate whether you proceed with a project or not. Generally, a positive net present value means the project is worthwhile. Amy Gallo, *A Refresher on Net Present Value*, Harvard Bus. Rev. (Nov. 19, 2014), https://hbr.org/2014/11/a-refresher-on-net-present-value [**https://perma.cc/YXC8-9F9V**].

[42] Jeff Brown, *Latest CEO Pet Project to Fail: AOL's Patch*, CNBC (Dec. 16, 2013, 3:34 PM), https://www.cnbc.com/2013/12/16/latest-ceo-pet-project-to-fail-aols-patch.html [**https://perma.cc/E27F-ALT5**].

[43] *Id.*

[44] Matt Burns, *Patch Hit with Sweeping Layoffs as New Owner Hale Global Restructures,* Tech Crunch (Jan. 29, 2014, 11:58 AM), https://techcrunch.com/2014/01/29/patch-hit-with-sweeping-layoffs-as-new-owner-hale-global-restructures/ [**https://perma.cc/8L6D-72V7**].

[45] Meinhard v. Salmon, 164 N.E. 545, 547 (N.Y. 1928); Max Stul Oppenheimer, *Fame: Ownership Implications of Intellectual Property and Agency Law*, 30 Fordham Intell. Prop. Media & Ent. L. J. 447, 477 (2020).

[46] Solutions to these overarching agency issues are discussed *see infra* Part III.

[47] Office of Investor Education and Advocacy, *A Roadmap to Your Financial Security Through Saving and Investing*, SEC, https://www.sec.gov/investor/pubs/sec-guide-to-savings-and-investing.pdf [**https://perma.cc/Q2L8-26QU**].

[48] *See* Leo E. Strine, Jr., *Who Bleeds When the Wolves Bit?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System,* 126 Yale L.J. 1870, 1876 (2017).

[49] I.R.C. § 72(t)(2)(A)(i)(2012). Also applies to IRAs. *Id.* § 408A(d)(2)(A)(i).

[50] Leo E. Strine, Jr., *Supra* note 41, at 1880.

[51] Alan Palmiter, Frank Partnoy & Elizabeth Pollman at 903.

[52] Afra Afsharipour, *Bias, Identity and M&A*, 2020 Wis. L. Rev. 471 (2020).

[53] James A. Brickley, Clifford W. Smith, & Jerold L. Zimmerman at 589. For example, between 1993 and 1999 the value of corporate mergers represented 8.4 percent of the gross domestic product (GDP).

[54] David Gelles, *Hostile Takeover Bids for Big Firms Across Industries Make a Comeback*, N.Y. Times, (Jun. 12, 2014), https://dealbook.nytimes.com/2014/06/12/hostile-takeover-bids-for-big-firms-across-industries-make-a-comeback/ [**https://perma.cc/FQ2G-9HYP**].

[55] *See generally* Michael J. De La Merced, *Mergers Hit a 7-Year High, Propelled by a Series of Blockbuster Deals,* N.Y. Times (Jul. 1, 2014), https://dealbook.nytimes.com/2014/06/30/propelled-by-a-series-of-blockbuster-deals-mergers-hit-a-7-year-high/.

[56] *See infra* Part II.

[57] Griffin, *supra* note 15 at 71, 83.

[58] Afra Afsharipour, *Revaluating Shareholder Voting Rights in M&A Transactions*, 70 Okla. L. Rev. 127, 129 (2017).

[59] *Id.*

[60] *Id.*

[61] Hugh A. Simons & Nicholas Bruch, *Do Mergers Increase Profitability?*, L. J. Newsletters (Jan. 2018), https://www.lawjournalnewsletters.com/sites/lawjournalnewsletters/2018/01/01/do-mergers-increase-profitability/ [**https://perma.cc/5LGR-EMZY**].

[62] *Id.*

[63] Griffin, *supra* note 15 at 85.

[64] *Id.*

[65] Theresa H. Maynard, Mergers and Acquisitions: Cases, Materials, and Problems 25 (5th ed. 2021).

[66] Griffin, *supra* note 15 at 84—85.

[67] *Id.* at 84.

[68] *Id.* at 86.

[69] *Id.* at 84.

[70] *Id.* at 83.

[71] Griffin, *supra* note 15 at 84.

[72] *Id.*

[73] *Id.*

[74] *Id.*

[75] *Id.* at 85—86.

[76] *Id.*

[77] Roger L. Martin, *M&A: The One Thing You Need to Get Right*, Harvard Bus. Rev. (Jun. 2016), https://hbr.org/2016/06/ma-the-one-thing-you-need-to-get-right [**https://perma.cc/LY3B-LVWV**]; *See infra* note 111.

[78] Gerrit M. Bechaus, *"Comply or Explain"—A Flexible Mechanism to Countervail Behavioral Biases in M&A Transactions*, 21 U. Miami Bus. L. Rev. 183, 187 (2013).

[79] Alan Palmiter, Frank Partnoy & Elizabeth Pollman at 545.

[80] *Id.*

[81] Schlensky v. Wrigley, 237 N.E.2d 776 (Ill. Ct. App. 1968).

[82] *Id.* at 777.

[83] *Id.* at 779.

[84] Alan Palmiter, Frank Partnoy & Elizabeth Pollman, *supra* note 23, at 546.

[85] Bechaus, *supra* note 71, at 202.

[86] *Id.*

[87] *Id.* at 202—203.

[88] *Id.* at 203.

[89] *Id.*

[90] Trefis Team, *How Microsoft Created $800 Billion in 3 Years—Can it Repeat?*, Forbes (Jul. 2020), https://www.forbes.com/sites/greatspeculations/2020/07/06/how-microsoft-created-800-billion-in-3-years--can-it-repeat/?sh=18276507dd1c [**https://perma.cc/LVT5-7E5X**].

[91] *See* Ken Smith, *The M&A Buck Stops at the Board*, 41 Mergers and Acquisitions 48, 49 (Apr. 2006); Afra Afsharipour, *A Shareholders' Put Option: Counteracting the Acquirer Over-payment Problem,* 96 Minn. L. Rev. 1018, 1028 (2012); Maynard, *supra* note 58, at 26 [*emphasis added*].

[92] *See* John Callaham, *Google Made Its Best Acquisition Nearly 16 Year Ago: Can You Guess What It Was?*, Android Authority (May 2021), https://www.androidauthority.com/google-android-acquisition-884194/ [**https://perma.cc/9GJB-48FF**] (Admittedly, there are exceptions. For example, Google purchased Android for what was considered an exorbitant price at the time. Years later, Google was able to capitalize on the purchase of Android and turn it into a profitable mobile line).

[93] *See* Robert F. Bruner, *Deals from Hell: M&A Lessons That Rise Above the Ashes*, N.Y. Times 265—291 (2005) (For example, America Online and Time Warner reported a $45 billion write-down in 2003 and then a $100 billion yearly loss.); *See also Strife of Brian,* Economist (Sep. 7, 2011), https://www.economist.com/finance-and-economics/2011/09/17/strife-of-brian [**https://perma.cc/V2SY-GSWH**] (Countrywide acquisition by Bank America that led to $30 billion in legal settlements and mortgage-related losses.); *See, e.g. infra* note 98 and accompanying text. *See also Fools Rush In: 37 of the Worst Corporate M&A Flops*, CBI Insights (Oct. 2018), https://www.cbinsights.com/research/merger-acquisition-corporate-fails/ [perma.cc/MGC4-STT8 (https://perma.cc/MGC4-STT8)].

[94] *See* Afra Afsharipour, *Revaluating Shareholder Voting Rights*, 70 Okla. L. Rev. 127, 128 (2017).

[95] *See id.*

[96] *See id.*

[97] *See id.*

[98] *See* Maynard, *supra* note 58, at 35.

[99] Bechaus, *supra* note 71, at 195.

[100] *Id.*

[101] *Id.* at 196.

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] *Id.*

[106] *Id.*

[107] Alan Palmiter, Frank Partnoy & Elizabeth Pollman, *supra* note 23, at 28.

[108] Robert Fields, *EXECUTIVE COMPENSATION AND EMPLOYEE BENEFITS ISSUES IN M&A SITUATIONS,* RMF (2021), https://www.rmfieldslaw.com/post/executive-compensation-and-employee-benefits-issues-in-m-a-situations [**https://perma.cc/NQV6-DUCT**].

[109] Jeffrey A. Krug, *Why Do They Keep Leaving?*, Harvard Bus. Rev. (2003), https://hbr.org/2003/02/why-do-they-keep-leaving (https://hbr.org/2003/02/why-do-they-keep-leaving) [**https://perma.cc/PY3G-KUUM**].

[110] *Id.*

[111] *See* Afra Afsharipour, *supra* note 45, at 481.

[112] *See* Jeffrey A. Krug, *supra* note 102.

[113] Jo Danbolt, *The Real Effects of Earnout Contracts in M&As*, J. of Fin. Research 607 (2021).

[114] *Id.* at 608.

[115] *Id.*

[116] *Id.* at 608—609.

[117] *Id.* at 609.

[118] *Infra* Part II.A.ii.

[119] Daniel R. Avery & Goulston & Storrs, *Earnout Provisions,* BL 2 (2020) (referring to a study completed by the American Bar Association's Private Target Mergers and Acquisitions Deal Point Studies. Interestingly, 60%-70% of earnout provisions used earnings before interest, taxes, depreciation, and amortization (EBITDA) or revenue as the principal earnout metric).

[120] *Id.*

[121] 1 M&A Practice Guide § 9.10 (2021).

[122] Daniel R. Avery & Goulston & Storrs, *supra* note 112 at 5.

[123] 1 M&A Practice Guide § 9.10 (2021).

[124] *Id.*

[125] *Id.*

[126] Daniel R. Avery & Goulston & Storrs, *supra* note 112 at 5.

[127] *Id.* at 4.

[128] *Id.*

[129] 1 M&A Practice Guide § 9.10 (2021).

[130] Daniel R. Avery & Goulston & Storrs, *supra* note 112 at 5.

[131] Jay Coen Gilbert, *What eBay's Court Fight with Craigslist Reveals,* Forbes: Corp. Soc. Resp (Sep. 2010), https://www.forbes.com/sites/csr/2010/09/21/what-ebays-court-fight-with-craigslist-reveals/?sh=6db8dccb2dd8 [**https://perma.cc/886R-854Q**].

[132] *Id.*

PREVIOUS

The Reciprocity of Conservation and Hunting: Improving Kentucky's North American Model of Wildlife Conservation
(/online-originals/reciprocityof-conservation-and-hunting-improving-kentuckys-north-american-model-of-wildlife-conservation)

NEXT

NOT SO LUCKY IN KENTUCKY: CONSTITUTIONALITY OF KENTUCKY'S SLOT MACHINES
(/online-originals/not-so-lucky-in-kentucky-constitutionality-of-kentuckys-slot-machines)

KLJ Kentucky Law Journal (859) 257-1678 | kentuckylawjournal112@gmail.com | 620 Limestone Lexington, KY 40508

(https://kentuckylawjournal.org)