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In the 1980s, hostile takeovers became all the rage and boards lived in fear of 'corporate raiders', such as Carl Icahn.

In 1988, for example, there were no less than 160 unsolicited takeover bids for US companies. The hostile takeover became the defining symbol of US-style capitalism, encapsulated in the 1987 movie classic *Wall Street*.

However, after the late 1980s, unsolicited takeover bids decreased in number and, over the past decade, became relatively rare. For example, last year, there were fewer than 15 hostile takeover offers for US companies. The reasons for this development are manifold. One reason is the board-friendly case law on takeover defences – particularly the decisions of the Delaware courts in the Airgas case, which upheld a target company's poison pill even though the bidder's tender offer had been pending for a year. Antitrust is another, which makes it more difficult for companies with large market shares to acquire competitors without some level of cooperation from the target company. Yet, among them all, one reason in particular stands out: the previous 11-year bull market in the US, which until March of this year drove the share prices of public companies ever upward, making

potential target companies too expensive for their competitors.

In the past few months, however, hostile takeovers have been making a comeback, starting with the battle for real estate fintech CoreLogic in June. At the time of this article, multiple unsolicited takeover bids are already underway. This not surprising. Historically, hostile activity has increased following market downturns, most recently after the 2008 financial crisis. The Covid-19 crisis is similar in that regard. The pandemic has caused severe dislocations in the stock market. Even though the major indices have recovered since the market nadir in March, the recovery has not treated all companies equally. Countless companies continue to suffer from depressed share prices.

This phenomenon is not limited to the industries hit hard by the pandemic, such as oil and gas, travel and entertainment. The reality is that some companies have fared better during the crisis than others, regardless of the industry. But, for many companies, even a 100 per cent premium to its current share price is below

Unsolicited takeover bids were rare during the last decade, but are now experiencing a resurgence. So, how do you defend against and prepare for them?

The comeback of hostile takeovers

its 52-week high. These companies, many of whom enjoy enviable market positions, are affordable now for competitors, private equity funds and other potential acquirers, including hostile bidders, even at significant premiums. Activist hedge funds, which have been on the sidelines for most of the crisis, are also seeking new ways to deploy capital. As a consequence, shareholder activists are not only prepared to support hostile bidders, but they are increasingly showing a willingness to launch unsolicited takeover bids themselves – either alone or in partnership with a strategic or private equity firm.

Three common mistakes in hostile takeover defence

In this new environment, it is important to understand how to defend against hostile takeover bids. Like activism defence, hostile takeover defence is more art than science – each case tends to be different. Yet, defending against a hostile takeover bid is in many respects different from the defence against a shareholder activist campaign, and it is a significant mistake to treat them the same. There are three common mistakes we observe many targets making:

1 Failure to deploy takeover defences

Many boards are loath to use legal defences against hostile takeover bids. To be certain, corporate defences have fallen out of favour in the past two decades. Directors of countless public companies have been directly or indirectly admonished by the proxy advisory firms, ISS and Glass Lewis, and large institutional investors for adopting poison pills, defensive bylaw amendments and other legal defences – when adopted in the face of an activist campaign.

Deploying defensive measures in response to an unsolicited takeover bid however is more than fair game. Hostile bidders often typically have at least one unfair advantage: timing. They tend to approach their prey opportunistically, when a target's share price is depressed or a company is facing a crisis. To counter this, a target company needs one thing more than anything: time. Management and the board need time to formulate a response and

demonstrate that the company's intrinsic value is significantly higher than the bidder's offer price, if that is the case.

To that end, it is important for a target to consider adopting a poison pill to limit accumulation of a large position and/or to ensure that any tender offer cannot close without the board's approval. Furthermore, since the next step of a hostile bidder is, typically to launch a proxy fight to oust the incumbent directors, a board is well-advised to consider delaying upcoming director elections. This may be accomplished by postponing an upcoming annual shareholder meeting or by placing procedural restrictions on the ability for shareholders to call special meetings or to act by written consent. To be clear, this must be considered thoroughly with the advice of counsel, since certain of these measures are lawful, while others may not be, in the face of an imminent or pending takeover bid.

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2 Overemphasis on corporate governance

In activist campaigns, corporate governance issues are typically front and centre. While an activist's economic case reigns supreme, ISS and Glass Lewis are extremely focussed on a company's corporate governance practices when making their vote recommendation in any proxy contest. The same applies to the decision-making of many governance-focussed institutional investors, particularly passive investors (e.g. the index funds). This focus makes a certain degree of sense because a focal point of any proxy contest is the question of which directors are best positioned to drive value.

Hostile takeovers are different in that regard. The focus shifts almost exclusively to

economics. A target company's decision to refresh the board composition, change executive compensation practices or increase shareholder rights is not nearly as relevant when the decision put to shareholders is whether an offer at a specific price is sufficient to surrender their shares. The significant changeover in the shareholder base that often follows a takeover bid, with the entry of risk arbitrageurs and other hedge funds, amplifies this effect. At the end of the day, the primary question is who can deliver more near-time value to the shareholders: the target's incumbent board and management team or the hostile bidder's offer? It is all about cold hard cash. Not much else matters.

3 Hesitance to develop credible alternatives

In the face of a hostile takeover, a target board needs to become creative. While arguing that management's 'standalone plan' will deliver more value to shareholders might very well be true, it is often difficult to sustain unless a company has tangible proof points to show in the near future (e.g. the earnings beat Wall Street consensus). The 'trust us' defence becomes all about the credibility of the incumbent board and management team – with uncertain outcome. Therefore, it is, in most cases, important for a board to develop credible alternatives to the hostile bidder's offer.

This involves a thorough review of strategic alternatives with the assistance of financial and other advisors. This does not necessarily mean that such a review process should be publicly disclosed (as competitors could use this to poach key personnel and steal market share), but a board needs to understand all other realistic options to create significant shareholder value. Such options may include selling or spinning off divisions, acquisitions of other companies or assets, bringing in new investors (strategic or financial), returning capital to shareholders, or putting the company up for sale in a formal process. »

» A failure of a board to explore these alternatives unnecessarily weakens a company's hand in a takeover defence battle. It can also subject the board to allegations that it did not fulfill its duty of care when evaluating an unsolicited takeover proposal.

Seven steps to be prepared for a hostile takeover bid

The most common mistake, however, of companies facing a hostile takeover occurs well before the arrival of the 'barbarians at the gate': lack of preparation. To be prepared, a company should take the following essential steps:

1 Have an emergency communications response plan

Many bidders first approach their targets privately and in a friendly manner. This reflects the reality that friendly deals tend to be less expensive than hostile ones and public hostility tends to damage the value of the target due to the uncertainty experienced by employees, customers and other stakeholders.

In the current share price environment, however, many bidders are cutting the private phase short or going public right away. Should a hostile bidder go public, it is crucial to have an organised internal process to avoid mistakes in such a fast-paced environment. Most important is an effective and timely public response as soon as possible and certainly in the same news cycle. Therefore, a company should prepare a 'break the glass' communications response plan that includes draft response press releases and media statements as well as related talking points and Q&A for inquiries from investors, the media, employees, and other stakeholders.

2 Review the charter and bylaws

Many companies have outdated organisational documents that have never been reviewed by attorneys who have been through dozens of proxy fights and hostile takeover bids. Therefore, it is important to have experienced defence counsel review a company's organisational documents to assess legal weaknesses from a defence perspective. Among other things, the 'fine print' relating to the timing of shareholder meetings, the conduct of meetings, the counting of votes, and inspection of elections is often severely deficient. The ideal time to amend bylaws to address these issues is during 'peacetime', well before a hostile bidder or activist approaches the company.

3 Draft a 'shelf' poison pill

Every public company should have an up-to-date, fully drafted and negotiated poison pill 'on the shelf' to enable the board to react quickly in the event that a hostile takeover bid is launched. There is insufficient time to draft a shareholder rights plan from scratch if, for instance, a hostile bidder files a Schedule 13D with a 'toe hold' stake of 10 per cent to 15 per cent of the shares and continues to accumulate stock. If a company takes several days to adopt a poison pill, the bidder may very well acquire a 20 per cent



PREPARING FOR BATTLE
Are you ready for an unsolicited takeover offer?

Hostile takeover bids are 'bet the company' situations and, by their nature, are a threat to the survival of the company. Therefore, companies should assemble a response team during peacetime to be on standby in the event of an attack

or 25 per cent position in the meantime. The loss of control of a company can, in fact, result from the tardy adoption of a poison pill.

4 Monitor the stock

It is important to retain a sophisticated stock watch firm to monitor trading in the company's stock to receive advance notice in the event a hostile bidder builds a 'toe hold' stake. This, in turn, enables the board to take defensive measures in a timely manner,

including, but not limited to, the adoption of a poison pill.

5 Engage the shareholders

Takeover battles are typically decided not by judges or the media, but by the shareholders. For this reason, it is crucial to have a robust

shareholder engagement programme – both in proxy season and during the 'off-season' – to build confidence in, and understanding of, the company's strategic plan.

6 Conduct a financial self-evaluation

A board should always have a solid understanding of its strategic alternatives. Therefore, a board should, with the assistance of a financial advisor and other consultants, routinely evaluate the strategy, business plan, capital allocation and performance of the company and other potential strategic alternatives available to the company.

7 Retain a response team

Hostile takeover bids are 'bet the company' situations and, by their nature, are a threat to the survival of the company. Therefore, companies should assemble a response team during peacetime to be on standby in the event of an attack. There is also no time for 'training on the job'. It is important that companies hire specialists with extensive experience in defending companies from a hostile attack. After all, no one would ask a general practitioner to perform their heart bypass, either.

Conclusion

Hostile takeovers are back. You may welcome or bemoan the development. Either way, it is important to adjust to the new reality. The question to ask is this: if your company was approached by a hostile bidder tomorrow, would you feel prepared? 🧠

This article originates from a panel discussion about 'Hostile Takeovers During COVID-19' at the Society for Corporate Governance's Fall Conference in New York on 15 September 2020.