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The Changing Shape of Hostile Takeovers

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Over the last several months, a number of hostile offers have utilized several new tactics. These new maneuvers may lead to targets erecting innovative defenses.

Partnering between Strategic Acquirors and Activist Investors

The most notable recent development is the partnering by strategic acquirors and activist investors to wage a hostile bid. The strategic and the activist form a new vehicle, with the vehicle purchasing a large percentage of the target's stock (including through call options so as to not trigger a Hart-Scott-Rodino antitrust filing until exercise of the options), and the strategic publicly commencing a hostile bid against the target. This new structure combines and leverages an activist's rapid accumulation of stock or call options, with the strategic's financial wherewithal to fund and legitimize a hostile bid. The result of this two-front attack—facilitated significantly by the 10-day window before a Schedule 13D must be filed after crossing the 5% threshold disclosing such stock accumulation—is the target belatedly becoming aware of the rapid acquisition of a large percentage of its stock, and at the same time having to defend against a publicly announced hostile bid.

As a means to address this combined stealth accumulation of stock and hostile bid, a target could adopt a poison pill with a 5% acquiring person threshold that would trigger solely upon the failure by a non-passive investor to file a Schedule 13D "promptly" (meaning within 1 business day) after crossing the 5% threshold. A more unorthodox and as yet untested defensive measure could be to adopt a bylaw similar in concept to a REIT "excess share" provision, that would require a Schedule 13D filing to be made by a non-passive investor promptly after acquiring shares or options over the 5% threshold. Failure by the activist or raider to make such a Schedule 13D filing would permit the target to: (i) repurchase the acquired shares at the lower of the price paid or the fair market value; and/or (ii) require the acquired shares to be deposited in a trust to be promptly resold to one or more passive investors—in either case thereby neutralizing the benefits of a stealth accumulation of stock by the activist to support the strategic's hostile bid. While such a bylaw would admittedly be an aggressive measure creating a risk of a litigation challenge, if upheld it would be a novel way to outflank stealth accumulations. A less aggressive formulation of this bylaw would dispense with the repurchase provision, and simply bar the activist or raider who failed to "promptly" file a Schedule 13D from nominating directors or proposing business at the next occurring annual stockholder meeting. Because the purpose of all these defenses would be transparency and disclosure to the market, and the effects could be avoided by prompt disclosure, such defenses should be justifiable to the proxy advisory services as a reasonable means to assure that all target shareholders are on an equal informational footing.

The Risk of "Shareholder Referendums"

Another notable development is the calling of a "shareholder referendum". Instead of waiting for the annual stockholder meeting (or calling a special stockholder meeting as (and if) permitted by state law, or by the target's charter or bylaws), the activist or raider simply schedules a referendum to be held and invites all target shareholders. The purpose of the referendum is to "vote" on a precatory resolution, such as resolving that the target negotiate with a hostile bidder. While such a resolution is non-binding, in a takeover context it can place significant pressure on the target board to "come to the table". In takeover defense strategy, the target is typically best served by not allowing the hostile bidder to dictate when it has an audience with the target's stockholders—in fact, that is the reason why most targets opt out of state law control share acquisition statutes, which enable a bidder to do just that. The shareholder referendum undermines this defensive maneuver and puts the target in a quandary. If the target solicits votes in opposition to the insurgent, the target risks legitimizing the referendum. Ignoring the referendum allows the hostile bidder to occupy the entire stage without any countervailing voice to be heard.

One way to eliminate the shareholder referendum risk could be through a poison pill. It would require making clear that the exception for soliciting revocable proxies not counting as beneficial ownership would only apply in respect of a shareholder meeting called pursuant to state law or the target's charter or bylaws. Therefore, a referendum would not be eligible for the exception and would likely deter a hostile bidder from seeking a shareholder referendum out of concern over triggering the poison pill. Another solution would be to rely on an advance notice bylaw that disqualifies any bidder from making nominations or proposing business at the next occurring annual stockholder meeting (and, if applicable, special stockholder meeting) if that bidder sought to hold a shareholder referendum. Such a bylaw should discourage the holding of a referendum in light of the downside to a hostile bidder of having to sit on the sidelines at the next occurring stockholder meeting without being able to effect change at the target board.

Decoupling Equity from Hostile Equity Bids

Hostile bids using equity of the bidder as consideration can be difficult to execute under the best of circumstances. Even when the stock market is on the upswing, many shareholders often feel that “cash is king” in large part due to the uncertainty as to the value of stock consideration (which collars can mitigate only to some extent). Target companies also understand that a common response to a hostile equity bid is to raise doubts about the true value of the hostile bidders’ stock. As a result, targets will publicly attack the hostile bidder’s stock as overvalued with the goal of placing downward pressure on the hostile bidder’s stock price, thereby lowering the per share price of the hostile bid so that the target can claim the price offered is inadequate. In addition, hostile bidders offering more than 20% of their own stock as consideration face other risks, including: (i) triggering a vote of the hostile bidder’s shareholders under the NYSE and Nasdaq rules, with the attendant uncertainty as to the outcome of such a vote; and (ii) potentially inviting an unsolicited bid for the hostile bidder itself (the hunter becomes the hunted) or encouraging an activist investor to “weigh in” on the hostile bidder’s plans.

Some hostile bidders anticipate this hazard and structure around it by converting their bid to all cash (or at least minimizing the equity component), while concurrently selling equity via a public offering or a PIPE to a private equity investor. Decoupling equity from the bid removes the uncertainty regarding the value of the consideration and consequently the ability of the target to argue on such basis that the hostile bidder’s offer is inadequate from a price standpoint. In addition, the recent trend of acquirors receiving a lift in their stock price after an announced offer may lead to more bidders seeking to monetize such a lift while it lasts by selling their stock, and instead using all cash in the bid.

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With new strategies and defenses coalescing, it is likely that the next takeover contests will continue to evolve and give rise to other innovative tactics by activists, hostile bidders, and targets.

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