Beware Of Sharks: Top Takeover Defenses

By Jacqueline Bell

Law360, New York (September 11, 2009) -- As the economy takes steps toward recovery, the stage may be set for an uptick in hostile takeover activity this fall, experts say, making it increasingly important for public companies to review their battle plans.

“It's something you might compare to pent-up demand for car sales. People have been shopping and thinking, and haven't had the opportunity, the time and the funds to execute,” said Patrick Quick, a partner at Foley & Lardner LLP. “When the opportunity arises, I do think the pent-up demand will show in some hostile activity.”

If firms find it easier to get financing for deals in the fall, buyers who have been sitting on the sidelines may well be motivated to take action, experts said.

Also, a variety of companies will likely be pulling themselves, and their battered stocks, out of the economic doldrums at different rates, they said.

Times of economic turbulence tend to expose weaker companies, which may whet the appetite of rivals who are finding their footing faster, and looking to make a deal, experts said.

Buyers may also find that their potential targets are unwilling to engage in friendly negotiations in this economic climate, they said.

Companies with a shaky stock price are likely to believe that their stock is undervalued, making them more motivated to wait until things improve before they consider the possibility of a sale, according to experts.

Negotiating a friendly deal under those conditions is likely to be tough, and a potential buyer may find a hostile strategy is the only available option, they said.
Add this to the equation: Many companies over the past few years have been dismantling their traditional defenses, under pressure from shareholders who disapprove of the measures, experts said.

“The decline of the market combined with rise of shareholder activism and the broad scale dismantling of staggered boards and other takeover defenses makes more publicly held companies vulnerable to a hostile takeover than at any time in the past several decades. One should expect that there are acquirers out there that will act,” said James Morphy, a partner at Sullivan & Cromwell LLP.

In this type of environment, experts advise deploying several key measures to ward off sharks.

**Mind Your Own Business**

Mergers and acquisitions specialists say the first step to fending off hostile maneuvers is crafting a strong strategic plan, and ensuring that the board is comfortable with it and able to discuss it with shareholders.

“Then they can defend the plan, and say this is what we’re planning to do to move forward, we think this plan works, and we think you’re better off hanging with us as we climb out of this economic dungeon,” Quick said.

Having a strong, well-communicated vision for where the company is going, at least in the near term, and ensuring that the shareholder base has confidence in the strategic plan, the board and the company's management is a vital foundation to have in place before any hostile bids appear on the horizon, experts said.

“You can have whatever else you want in terms of defenses, but you have to have a strategic plan for your business that makes sense going forward, in order to be able to show people that you know what you’re doing and you can return value to them,” said Thomas Rice, a partner at Baker & McKenzie LLP. “If you don’t have that, someone with enough willpower will be able to take you, one way or another.”

One note of caution here: Public companies have to be willing to communicate a strategic plan to all of their shareholders, not just a select few, or risk running afoul of U.S. securities laws, experts said.

**Know Yourself, Know Your Industry**

Another key to building a strong defensive posture is having a clear understanding of where your company is positioned in the market, and how the industry at large is likely to shape up in the near term, experts said.

It's vital for the board to be up to date not only on what's going on inside the company, but also what a firm's rivals are dealing with, they said.
Is the industry likely to go through a period of consolidation? Would the company look attractive to a third party? What competitors are likely to be looking for buying opportunities? These are all key questions that are important to examine, according to experts.

“You really need to know the risk profile of a company in order to know how to respond,” said John Tamisiea, a partner at McDermott Will & Emery LLP.

In addition, public companies should undergo a comprehensive review of their takeover defenses, experts said.

Does the company have a staggered board? A poison pill in place? When was the last time the poison pill was looked at?

A key calculation in this environment is estimating how much time a company is likely to have to deal with a hostile offer, experts said.

For example, if a company has held on to a structure that includes a staggered board of directors, that will slow down any takeover process; because the terms of the directors are staggered, the entire board can't be replaced at the same time, they said.

But if a company has long ago tossed the staggered board system, their tactics in a hostile situation will, by necessity, be different, experts said.

“The critical question, and one every director of a public company should have the answer to, is how much time is the board likely to have to deal with an unsolicited bid. That will largely define what alternatives are likely to be available if and when a bid comes,” Morphy said.

**In Case of Emergency, Break Glass**

Firms should have a group of individuals that are ready to spring into action quickly in the event of a hostile bid, experts said.

“Every company should have a takeover response team, including the people in the company who are going to be leading the effort. An investment banking firm, a public relations firm, a proxy soliciting firm, and of course, experienced M&A lawyers,” said Stephen Fraidin, a partner at Kirkland & Ellis LLP.

Don't skimp on communications, either, because hostile players are becoming increasingly adept at using the fast-paced news cycle to their advantage, experts said.

Board members should also be briefed on how a hostile bid is likely to play out, and what their response should be if they get a late-night phone call revealing the prospect of a hostile bid, they said.
Reconsider the Poison Pill

As a defensive measure, companies should certainly think of a poison pill as a possible option, experts said, in spite of its waning popularity in the face of shareholder activism against it.

"The poison pill is not dead. Pressure from hedge fund activists and good governance groups has made poison pills a lot less prevalent than they have been. That's not to say they can't be used properly and they won't be used properly in the future," Fraidin said.

A common version of a poison pill, designed to make a company less desirable, is a provision that allows current shareholders to buy additional stock at a significant discount if there should be a takeover attempt, diluting the potential buyer’s stake in the company, experts said.

Sometimes called a shareholder rights plan, the poison pill is usually triggered by one shareholder acquiring a certain predetermined percentage of the company's total shares, they said.

That's a typical design, but poison pills come in a wide variety of forms, and can be tailored to a company’s particular circumstances, experts said.

While a number of public companies have been eliminating their poison pills under pressure from shareholder groups, it's not a bad idea to consider the possible benefits of putting a pill in place in the current economic environment, or at least keeping one on the shelf, according to experts.

“I’m a guy that recommends that you maintain in effect a shareholder rights plan. I think that does a couple of things. It shows people you’re ready to defend yourself and that you’re sophisticated in takeover matters,” Quick said. “The next best thing is keeping a plan on the shelf.”

Still, a company should think carefully about what signals it may be sending if and when it decides to dust off an "on-the-shelf" poison pill and put it into action, experts said.

Suddenly adopting a shareholder rights plan can shine a spotlight on an impending threat, they said.

“It looks bad if you do it when storm clouds are on the horizon,” said Robert Schreck, a partner at McDermott Will & Emery.