Takeover and Activist Response Checklist

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Notwithstanding the constant criticism from academics, activists and other so-called governance experts, takeover preparedness has never been more important. Failure to prepare for a takeover or demands from an activist exposes potential targets to pressure tactics and reduces the target’s ability to control its own destiny. This outline provides a checklist of matters to be considered in putting a company in the best possible position to respond to a takeover bid, pressure from an activist, a proxy fight, or a consent solicitation or to negotiate a merger. This is a general comprehensive checklist; not all the matters in this outline are appropriate for any one company. Takeover defense is an art, not a science. It is essential to be able to adopt new defenses quickly and to be flexible in responding to changing takeover tactics. Whatever the state of the law may be and however it may change, in order to achieve the best result in a takeover situation a company must have effective defenses and keep them up to date. In addition to regular portfolio reviews by management, an annual board of directors “fire drill,” with participation of the company’s investment banker and legal counsel, is important for dealing with an attack, if one comes. Of equal importance, a company must maintain excellent investor relations, with the CEO and CFO having regular contact with the key portfolio managers and analysts.

Advance Preparation

1. Create Team to Deal with Takeovers
   - Small group (2-5) of key officers plus legal counsel, investment banker, proxy soliciting firm, and public relations firm
   - Ensure ability to convene special meeting of board within 24 to 48 hours
   - Continuing contact and periodic meetings are important
   - A periodic fire drill is the best way to maintain a state of preparedness
   - Periodic updates of board
   - Warlist of contacts updated regularly

2. Prepare Instructions for Dealing with:
   - Press
   - Message boards, blogs and other real time sources
   - Stock Exchange
   - Directors
   - Employees and unions
   - Customers/suppliers/banks
   - Institutional investors and analysts
   - Public officials and government contacts

3. Review Structural Defenses, Consider Implementing Additional Defenses If Necessary
   a. Bear in mind:
      - In many cases a structural defense is possible only if there has been careful advance preparation by the Company and its investment banker and legal counsel (see 7 and 8 below)
While staggered election of the board of directors and supermajority merger votes or other shark repellents have had limited success in defeating most any-and-all cash tender offers, they may be effective in deterring other types of takeovers (including proxy fights) and are worth retaining, if the Company has them currently.

Structural defenses and supermajority voting requirements need to be reviewed in light of negative reactions from institutional investors and impact on corporate governance ratings and institutional voting services’ recommendations.

b. Charter and bylaw provisions

- Staggered board
- Ability of stockholders to act by written consent
- Advance notice provisions for nominations and business at stockholder meetings
- Ability of stockholders to call a special meeting
- Ability of stockholders to remove directors without cause
- Ability of stockholders to expand size of board and fill vacancies
- Supermajority voting provisions (fair price, etc.)
- Authorization of sufficient common and blank-check preferred stock
- Director qualification requirements
- Cumulative voting
- Preemptive rights
- Constituencies
- Majority voting (resignation with acceptance in business judgment of the board)

c. “Poison Pill”

- Permits board to “just say no,” *Airgas* case
- Purported antidotes ineffective
- Consider treatment of derivatives
- Institutional pressure to submit pills to a shareholder vote
- Dealing with shareholder proposals and director withhold vote recommendations for pill renewals
- Avoid poison pill policies, governance principles and by-laws as they limit flexibility
- “Dead Hand” provision (not valid in Delaware)

d. Structure of loan agreements and indentures

e. Change of control triggers in joint venture agreements and other material contracts

f. ESOP arrangements; plans to increase employee ownership

- Dept. of Labor and SEC fiduciary considerations

g. Customer protection plans

h. Options under state takeover laws

- Control share
- Business combination
- Fair price
- Pill validation 
- Constituencies 
- Long-term prospects vs. short-term price 
- Disclosure 

4. **Additional Advance Preparation**

- Review of the business portfolio and strategy: dividend policy, leverage, share repurchase, divestitures and spinoffs
- Advance preparation of earnings projections and liquidation values for evaluation of takeover bid and alternative transactions
- Amendments to stock options, employment agreements, executive incentive plans and severance arrangements ("golden parachutes")
- Amendments to employee stock plans with respect to voting and accepting a tender offer
- Protection of overfunded pension plans
- White knight/white squire arrangements
- Review availability of regulatory defenses, including CFIUS

5. **Shareholder Relations**

- Maintain excellent investor relations
- Review dividend policy, analyst presentations and other financial public relations
- Prepare fiduciary holders with respect to takeover tactics designed to panic them
- Review trustees for various company plans and determine if changes required
- Monitor changes in institutional holdings on a regular basis
- Plan for contacts with institutional investors (including maintenance of an up-to-date list of holdings and contacts) and analysts and with media, regulatory agencies and political bodies
- Remain informed about activist hedge funds and activist institutional investors and about corporate governance and proxy issues
- Role of arbitrageurs and hedge funds

6. **Prepare Board of Directors to Deal with Takeovers**

- Maintaining a unified board consensus on key strategic issues is essential to success
- Schedule periodic presentations by legal counsel and investment bankers to familiarize directors with the takeover scene and the law and with their advisors
- Company may have policy of continuing as an independent entity
- Company may have policy of not engaging in takeover discussions
- Directors must guard against subversion by raider and should refer all approaches to the CEO
- Avoid being put in play; psychological and perception factors may be more important than legal and financial factors in avoiding being singled out as a takeover target
- Review corporate governance guidelines and reconstitution of key committees
- Discuss the importance of independent directors meeting with ISS and major shareholders during a proxy solicitation or a takeover

7. **Preparation by Investment Banker**

- Maintain up to date due diligence file and analysis of off-balance sheet values
- Consider defensive acquisitions, recapitalization, spin-off and tracking stock alternatives
8. **Preparation by Legal Counsel**

- Review structural defenses such as poison pill
- Review charter and bylaws; make sure they reflect “state of the art”
- Review business to determine products and markets for antitrust analysis of a raider
- Understand regulatory agency approvals for change of control
- Consider impact of change of control on business
- Consider disclosures that might cause a potential raider to look elsewhere
- Consider defensive acquisitions, recapitalization, spin-off and tracking stock alternatives
- Consider amendments to stock options, executive compensation and incentive arrangements and severance arrangements, and protection of pension plans
- Consider ESOPs and other programs to increase employee ownership
- Regular communication and periodic board presentations are important

9. **Prepare CEO to Deal with Takeover Approaches**

- The CEO should be the sole spokesperson for the company on independence, merger and takeover
- Handling casual passes (bearhugs)
- Handling offers
- Communications with officers and board of directors
- Company may have policy of not commenting upon takeover discussions and rumors

**Responding to Bidder Activity**

1. **Types of Activity**

- Accumulation in the market
- Casual pass/nonpublic bear hug
- Public offer/public bear hug
- Tender offer
- Proxy contest/consent solicitation
- Demand by activist for board representation

2. **Responses to Accumulation in the Market**

- Monitor trading, hedge fund accumulation and 13(f) filings
- Maintain contact with specialist
- Monitor analyst reports and react appropriately
- Look for bidder Schedule 13D and Hart-Scott-Rodino filings
- Board has duty to prevent transfer of control without premium
- Monitor/combust disruption of executives, personnel, customers, suppliers, etc.
- Monitor uncertainty in the market; change in shareholder profile
- Consider responses to accumulation:
• Poison pill can be structured so that flip-in takes effect at 10% to 15% threshold (N.Y. corporations 20%)
• Engage with activist
• Consider board seat/strategy change versus a creditable proxy fight
• Litigation
• Standstill agreement

3. Effect of Hart-Scott-Rodino Antitrust Act and Antitrust Enforcement Policies
   a. Hart-Scott should prevent dawn raids on big companies but under Hart-Scott a raider can buy up to $70.9M, and there is a 10% passive investment exception that has been misused by raiders
   b. A raider cannot complete its purchases until the requisite waiting period has expired:
      • Cash tender offer/bankruptcy: 15 calendar days
      • All other situations: 30 calendar days
      • If second request issued: 30 calendar days (10 calendar days in cash tender offer/bankruptcy) after substantial compliance
   c. Antitrust enforcement policies should be reviewed regularly, particularly when there is a change in administration or personnel
   d. Foreign filings are increasingly important

4. Responses to Casual Passes/Non-Public Bear Hugs
   • No duty to discuss or negotiate
   • No duty to disclose unless leak comes from within
   • Response to any particular approach must be specially structured; team should confer to decide proper response; meeting with potential bidder or activist may be best strategy
   • Keep the board advised; participation by independent directors may be critical

5. Response to Public Offers/Public Bear Hugs
   • No response other than “will call you back”
   • Call war list and assemble team; inform directors
   • Call special board meeting to consider bidder proposal
   • No press release or statement other than “stop-look-and-listen”
   • Consider trading halt (NYSE limits halt to short period)
   • Determine whether to meet with raider (refusal to meet may be a negative factor in litigation)
   • In a tender offer, Schedule 14D-9 must be filed within 10 business days and must disclose:
      • Board’s position (favor; oppose; neutral) and reasoning
      • Negotiations
      • Banker’s opinion (optional)

6. Special Meeting of Board to Consider Offer
   a. Board should be informed of the following:
      • Board has no duty to accept or negotiate a takeover offer
A premium over market is not necessarily a fair price; a fair price is not necessarily an adequate price.

The “just say no” response was approved in the Time Warner case and reaffirmed in the Paramount, Unitrin and Airgas cases and continues to be good strategy and good law.

Where outside directors are a majority, there is no need for a special committee to deal with takeovers nor do the independent directors need separate legal counsel.

Board must act in good faith and on a reasonable basis; business judgment rule applies to takeovers (modified rule applies in Delaware, where defensive action must be proportional to threat).

Partial offers present fairness issues which in and of themselves may warrant rejection and strong defensive action.

b. Presentation:

Management -- budgets, financial position, real values (off-balance sheet values), new products, general outlook, timing.

Investment banker -- opinion as to fairness or adequacy, assessment of bidder, quality of bidder’s financing, state of the market and the economy, comparable acquisition premiums, timing.

Legal counsel -- terms and conditions of proposal, legality of takeover (antitrust, compliance with SEC disclosure requirements, regulatory approval of change of control, etc.), bidder’s history, reasonable basis for board action.

c. Board may consider:

- inadequacy of the bid
- nature and timing of the offer
- questions of illegality
- impact on constituencies other than shareholders
- risk of nonconsummation
- qualities of the securities being offered (if bid is not all cash)
- basic shareholder interests at stake, including the past actions of the bidder
- strategic alternatives

### Strategic Alternatives

1. Remaining Independent

   a. “Just say no” defense is available as a legal matter, but may not be available in practice.

      - Refuse to redeem poison pill
      - Wage proxy fight to keep control of board (if board is staggered, bidder cannot get control and redeem pill without two annual meetings)

   b. Consider white squire arrangements

   c. Consider actions which decrease the Company’s attractiveness as a takeover target

      - New acquisitions (e.g., to create antitrust problems for bidder or increase size of transaction for bidder)
2. **Merger of Equals**

- Early, proactive efforts to pursue mergers of equals are necessary, as they are generally impossible to implement as a takeover defense.
- MOEs offer an alternative to an outright sale in which two organizations of similar size can combine their organizations in an effort to provide shareholders with greater long-term values.
- Management and other "social" issues are the key to an MOE's success or failure; these issues can be particularly challenging to address when combining companies with different corporate cultures.
- A variety of contractual and legal structures are available to implement agreements on social issues, although basic trust and common objectives are key.
- Careful planning is critical to avoid placing one or both parties "in play" prior to the announcement of the transaction and to anticipate possible shareholder concerns.
- Lock-up protections are appropriate to protect the transaction once it is announced. The record must show the MOE is not intended to be a sale of either company.
- MOEs can be "fair" even though higher short-term value could be obtained in an outright sale of the Company.

3. **Joint Ventures and Strategic Alliances**

- Strategic alliances and joint ventures have significant control ramifications.
- These transactions raise complex tax, accounting and sale of control considerations, which must be carefully analyzed against the backdrop of alternate strategic options.
- These transactions often present all the complexities of a full acquisition with the added complexity of shared governance and the need to construct an inherently imperfect exit mechanism.
- Short-term objectives need to be carefully balanced against potential longer-term ramifications.

4. **Sale of the Company**

a. Options:

- Locate white knight
- LBO/MBO
- Auction
- Sell significant subsidiary or division ("crown jewel" or other)
- Negotiate with bidder

b. Bear in mind: if Revlon duties are triggered, board will not be able to reverse course

c. Exploration by CEO of possible sale or merger (including strategic merger of equals) should only be undertaken after consultation with expert advisers

d. Form of confidentiality/standstill agreement used may have important ramifications