Yahoo's Position Is Weak, Its Options Few

Legal experts see little maneuvering room for Web portal as it tries to fend off Microsoft's hostile bid.

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For mergers and acquisitions lawyers, the January 31 letter that Microsoft C.E.O. Steven Ballmer sent to Yahoo's board—an unsolicited offer to buy the company for $44.6 billion, a 62 percent premium—was the first step of a very carefully choreographed dance.

Ballmer's offer, a "bear hug" in M&A parlance, was the first step. The letter ended with a mix of conviviality and (not so) veiled threat that suggests what might come next.

"My leadership team and I would be happy to make ourselves available to meet with you and your board at your earliest convenience," he writes. "Depending upon the nature of your response, Microsoft reserves the right to pursue all necessary steps to ensure Yahoo shareholders are provided with the opportunity to realize the value inherent in our proposal."

Translation: Let's have a proxy fight!

If the Yahoo board digs in its heels, reject Microsoft's offer, and resorts to its "poison pill"—an antitakeover maneuver to dilute the value of a hostile bidder's stake in the company—Microsoft's next shot would be to file a tender offer and nominate a new slate of independent directors. This is otherwise known as throwing the bums out.

Under Yahoo's bylaws, the notice for such a proposal and new slate of directors must be issued by March 13—enough time for the Yahoo directors to consider Microsoft's offer, while each side burns through some very high-priced legal advice, and Microsoft heads toward a possible proxy fight.

But if, let's say, you are Jerry Yang, Yahoo's chief executive officer, you might be rethinking the company's approach to corporate governance at this moment. For you see, Yahoo does not have a "staggered" board, so every director will stand for re-election—and could be voted out—at the next annual meeting. (The date of the 2008 meeting has not yet been set. The 2007 meeting was in June.)

In other words, should Microsoft succeed in winning over the hearts and wallets of Yahoo's biggest shareholders, the deal would be done almost regardless of what Yahoo's founders or current directors think.

Lawyers who advise corporate boards view staggered boards as yet another negotiating device when a company becomes a target. It can allow the company to hold out on an acquisition through at least one annual meeting, or press for a better price. Shareholder activists, however, see them as another means by which management can entrench itself at the expense of shareholders.

"Not having a staggered board reduces the likelihood of remaining independent in the face of a premium offer," says Lucian Bebchuk, a professor of corporate governance at Harvard Law School.

In 2002, the Stanford Law Review published a study in which Bebchuk showed that a staggered board nearly doubled the odds of a company remaining independent in the face of a premium offer from a hostile bidder.

"For Yahoo to be able to resist this, they would have to convince its shareholders there is value in continued independence," says Bebchuk. That is a tall order, considering that Yahoo last month said its profit fell more than 12 percent last year, even as revenue rose 8 percent.

Over the weekend, according to news reports, Google—the one company that absolutely cannot offer to buy Yahoo to rescue it from the hostile bid, because even today's relaxed antitrust regulators would probably reject such a deal—apparently reached out to Yahoo.

Google's lawyers certainly have been blogging about antitrust issues with Microsoft's bid.

Could the Yahoo board reject the Microsoft bid based on their concerns that the combination would not pass muster with antitrust regulators, either here or in Europe?

Morton A. Pierce, chairman of the mergers and acquisitions practice at Dewey & LeBoeuf, says it's possible, but not likely. "It becomes difficult in the face of a 62 percent premium to say I am just going to ignore this because I think there's an antitrust problem," says Pierce.

Ballmer's letter was an appeal to Yahoo's independent directors. If that fails, expect a campaign for the hearts and minds of its big institutional shareholders. But Microsoft is forbidden to woo them until the Yahoo board formally rejects Microsoft's offer. "They can't solicit people without the appropriate document on file, so I am assuming they are waiting for the board to respond," says Pierce.

Microsoft has turned to some very experienced counsel in the hostile M&A game: Charles I. "Casey" Cogut of Simpson Thacher & Bartlett, head of the firm's M&A practice, counsel to Kohlberg Kravis & Roberts, and a character in the 1980s book about hostile takeover, Barbarians at the Gate.

Yahoo is represented by a team from Skadden, Arps, Slate, Meagher & Flom, led by Palo Alto corporate partner Kenton J. King.