

# US takeover defences come tumbling down

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US companies are finding themselves increasingly exposed to unwanted takeover attention after a dismantling of companies' poison pills prompted by pressure from corporate governance activists.

Poison pills are designed to stave off unwanted attention by threatening to dilute the value and voting power of a potential acquirer once its stake in the company crosses a certain threshold.

Meanwhile, other defensive steps include staggered executive boards, where only part of the board of directors is replaced at any one time.

Groups that represent the interests of institutional shareholders, such as RiskMetrics, have found increasing success in setting such provisions removed, arguing that most anti-takeover provisions do not uphold shareholder interests.

Only 28 per cent of S&P 1,500 companies had a poison pill in place last year, down from 43 per cent in the previous two years, according to data from RiskMetrics. Staggered boards are also becoming rarer.

“Defensive barriers have come down dramatically. As staggered boards go away, poison pills fall and as the role of activist shareholders increases we would expect to see a meaningful trend towards more unsolicited and hostile deals,” says Paul Parker, head of global M&A at Barclays Capital.

Such a change in the US, well-known for the discretion granted to boards of directors in fending off bids, might increasingly be felt as the economic recovery takes hold.

“At this point of the business cycle, there may be a disconnect between a target board's expectations and a bidder's outlook,” notes Matthew Herman, a mergers and acquisitions partner in Freshfields' New York office. “Target boards that have failed to recognise the new economic reality may be reluctant when a buyer arrives offering a premium.”

But while the broader US trend has been towards lowering companies' defensive barriers, lawyers also argue that the courts have thus far continued to support the rights of boards to put in place and use defensive structures when the matter reaches litigation.

Lawsuits tend to come hand in hand with unsolicited takeover offers in the US. Last week, for example, Astellas Pharma of Japan launched a \$3.5bn hostile bid for OSI Pharmaceuticals of the US and sued to block OSI's poison pill.

However, few such cases actually get as far as a court judgment. A standard negotiating tactic, they fall away as deals die or as buyers and reluctant sellers come to an agreement.

However, last month, the Delaware Court of Chancery upheld the rights of US companies to ward off predators using poison pills.

The case in question – involving Selectica, a small software company – was unusual.

Selectica's pill trigger was set at a low level – 4.99 per cent. This was because it was intended to protect the value of the tax benefits resulting from the company's net operating losses (NOLs) – a type of pill that is becoming more common on the back of the recession.

Selectica's pill – activated when rival Trilogy bought through the trigger threshold – was the first time a pill had been triggered in the US since 1985. On that occasion, UK investor Sir James Goldsmith bought control of Crown Zellerbach, a paper producer, which exposed the flaws in the early generation of pills.

In spite of these quirks the court upheld Selectica's use of its pill, finding that the company was taking reasonable measures to protect itself against a threat.

Theodore Mirvis, a litigation partner at Wachtell, Lipton, Rosen & Katz – the firm generally credited with inventing poison pills – argued in a memo: “The decision constitutes a powerful rejoinder to those who have claimed that the pill has been weakened in recent years by newly emerging fiduciary constraints.”

Guhan Subramanian, professor of business law at Harvard Law School, however says: “Once a threat has been identified, the court does seem to be giving target boards a blank cheque to do anything they want. But the question remains, what kind of threat is sufficient to trigger that response?”

Indeed, in other instances the courts have shown an inclination to take a harder look at the validity of pills. Even in the Selectica case, the court noted that upholding the company's NOL pill guaranteed “the somewhat unpalatable outcome of acquiescing to the expansion of the universe of reasonable takeover defences in order to protect assets of questionable, even dubious, value.”

Mr Subramanian adds: “The idea of a forced pill redemption was unthinkable four or five years ago. But now it is very much part of the debate.”

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