

Immunomedics Proxy Contest

Schulte Roth & Zabel achieves unprecedented litigation victories

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A team of Schulte Roth & Zabel (SRZ) lawyers, led by partners Michael E. Swartz and Eleazer Klein, achieved a series of significant victories on behalf of venBio Select Advisor LLC (venBio), a long/short equity healthcare fund, in its proxy campaign at Immunomedics, Inc., a clinical-stage biopharmaceutical company. An investment fund that had never before been an activist, venBio turned to SRZ for counsel directly as a result of the firm's dominance in shareholder activism and because SRZ is highly regarded for its leading litigation practice.

The litigation arose from venBio's proxy contest to obtain majority control of the Immunomedics board. On Friday, February 10, 2017, less than a week before Immunomedics' already delayed annual meeting of stockholders was scheduled to take place, Immunomedics announced that it had entered into a transformative transaction with Seattle Genetics, Inc. to license IMMU-132, a promising triple negative breast cancer drug and Immunomedics' only viable product.

SRZ alleged that the transaction was a blatant act of entrenchment and virtually amounted to a sale of the Company. When Immunomedics announced the deal, it also adjourned the annual general meeting (AGM) for an additional two weeks so that it could try to swing the shareholder vote in favour of the incumbents. In a hard-fought litigation victory, SRZ prevented the record date and annual meeting dates from being moved (yet again) and essentially unwound the Seattle Genetics transaction. On May 4, 2017, following several court rulings in venBio's favour, Seattle Genetics and Immunomedics formally agreed to terminate the licensing deal.

"Never before has a major corporate deal been unwound in the context of a proxy contest on the basis that it was an entrenchment device," says Swartz, the lead SRZ litigation partner on shareholder activism and proxy litigation, who also advises on complex commercial, securities and business litigation, and antitrust. Those defending management teams against activists

are becoming more aggressive in their legal tactics, but the activists have demonstrated their tenacity and fought back. In this proxy contest alone, venBio filed one lawsuit and the Company and incumbent board filed two lawsuits. Volumes of documents were involved, and each twist and turn required rapid responses from counsel and courts.

Says Swartz, "Litigation is sometimes needed in these proxy contests to take victory across the finish line as we often see incumbent directors erect hurdles in the face of imminent defeat. Prime examples of this are the entrenchment devices used at Immunomedics, which included twice moving the annual meeting date and amending the bylaws to change the rules for electing directors, and culminated in an attempt to effectively sell the company through a global licence agreement. While we frequently challenge bylaw amendments enacted by incumbents during proxy contests in an attempt to tilt the playing field in their favour, there was no precedent for challenging an effective sale of a company on the basis that it was an entrenchment device". But signing the Seattle Genetics deal proved to be a very ephemeral victory for the incumbent board.

SRZ's client venBio, which was Immunomedics' largest shareholder with a 9.9% stake, lost no time in suing Immunomedics and the incumbent board to unwind the transaction and prevent additional postponements of the AGM date and proxy vote. The AGM occurred on March 3, 2017, at which time the company's stockholders voted to replace a majority of the incumbent board with the venBio slate, and just six days later SRZ obtained a Temporary Restraining Order (TRO) to stop the Seattle transaction from closing.

Transformational drug

In this case, the transformational asset was a treatment for the most aggressive type of breast cancer - triple-negative breast cancer. The drug, IMMU-132, which may also have applications for non-small cell lung cancer, and urothelial cancer, received

"Breakthrough Therapy Designation" from the US Food and Drug Administration (FDA) in February 2016 but the company did not have enough funds to go through phase 3 trials, according to venBio during the proxy contest. Immunomedics also historically had difficulty in attracting and retaining partners for licensing deals.

Overwhelming shareholder support

What makes the Immunomedics board's behaviour seem all the more extraordinary, and undemocratic, is that the activists had overwhelming support from shareholders (apart from insiders and Seattle Genetics). Though shareholders need not always heed the recommendations of proxy advisors, their affirmative advice was helpful and unanimous in venBio's favour. "It is highly unusual for all three proxy advisors (ISS, Glass Lewis and Egan-Jones) to fully support an activist type campaign for majority control of a board," says Klein, an SRZ partner in the M&A and Securities Group who serves as co-head of the global Shareholder Activism Group and as a member of the firm's Executive Committee.

Shareholders had much to be dissatisfied with. The Immunomedics founder had combined the roles of Chairman, Chief Scientific Officer and Chief Patent Officer, while his wife was CEO. It is not considered best practice corporate governance for the same person or related parties to jointly hold the roles of chairman and chief executive, but this is not that unusual in founder-managed companies. The real concerns at Immunomedics included the company's poor execution on strategy, including its failure to bring any significant product to market over its 35 year life, and the exceptionally generous remuneration (salary, bonus and stock options) and royalty agreements (which, for instance, continue after departure from the company) enjoyed by the Chairman. Immunomedics' share price performance had lagged far behind that of the Nasdaq biotech index for many years. "After so many years of frustration, the shareholders' last hope was in this campaign succeeding," reflects Klein.

venBio's proposals contained an extensive business plan that included finding new management and appointing a new slate of board directors, each intended to provide particular expertise. venBio's managing partner and portfolio manager, Dr. Behzad Aghazadeh, would offer expertise in capital markets and biotech. Manufacturing know-how would come from Scott Canute, who was previously President of Global Manufacturing and Operations at Genzyme. Regulatory expertise would be brought to bear by Peter Barton Hutt, a former Chief Counsel for the FDA, which approves US drugs. Khalid Islam, who co-founded Sirius Healthcare Partners, would provide clinical and corporate governance expertise. Those board members would be complemented by an advisory network. In response to the announcement of the proxy contest, Immunomedics installed four new directors, led by Jason Aryeh, managing partner of JALAA Equities, and claimed that venBio had wanted Aryeh to be a director. venBio, in fact, viewed the four as less well qualified than its candidates, partly due to their previous track records at various listed biotech companies.

Defence tactics

"Typical defence measures to litigate and put pressure on the activists generally have fallen by the wayside as investors do not appreciate this," said Klein. "Unfortunately, however, litigation is creeping back as a way to push back on activists and defence teams are using all options available and any means possible", Klein added. Says Swartz, "As a defence tactic, founders of companies and long-tenured boards sometimes enter into transactions to sell companies when it appears they will lose their seats at an annual meeting, but we were able to step in and stop this one."

venBio launched its long/short equity strategy in 2010 and Immunomedics is its first activist situation. In fact, venBio started off speaking with the board before proposing new directors. venBio is mainly renowned for being a biotech specialist, having originally been affiliated with a venture capital biotech division in San Francisco, with its hedge fund team based in New York. The nature of the industry made the case special because, unlike many other industries, a single

licensing agreement can be transformational for a biotech firm with only one advanced stage product. "Under Delaware law, stockholders would have a say in a sale of the entire company because that would require a stockholder vote. However, the complication here was that the agreement to license Immunomedics' only viable product to Seattle Genetics was an attempted de facto sale of the company without a stockholder vote," explains Swartz.

After it became clear that the venBio slate would win the shareholder election notwithstanding the incumbents' argument that the Seattle Genetics deal obviated the need for change, the Company sued venBio and its nominees in federal court in Delaware to try to delay the AGM via a TRO to give the incumbents yet more time to try to change the outcome of the vote. "The company tried to invalidate the proxy contest on the grounds that it was variously illegal, based on alleged false statements and disclosures that purportedly violated federal securities laws," says Klein.

The Company claimed, for instance, that venBio was acting in concert (without disclosure) with other shareholders and therefore violating 13D rules on disclosing groups and activist intentions. The Company also claimed 14A violations in relation to fair proxy solicitation, alleging that venBio was making false statements, violating securities law and using internet bulletin boards and chatrooms to coordinate its campaign. Immunomedics even tried to personalise the battle, by accusing venBio of making character assassinations. On March 2, 2017, the day before the AGM was scheduled to be held, Chief Judge Stark rejected the Company's requested TRO, finding, among other things, no reasonable likelihood of success on the merits of its claims. Accordingly, the path was cleared for the AGM to take place as scheduled.

On March 3, 2017, the venBio slate swept to victory. That night the incumbent board (except Jason Aryeh) sued the newly-elected venBio nominees in Delaware Chancery Court and asked that it be named as the interim or "status quo" board until its challenge to

the legitimacy of the election could be fully heard. Given the overwhelming election results and Chief Judge Stark's ruling that the Company was not likely to succeed on its 13D and 14A claims, the Delaware Chancery Court appointed the newly elected venBio-led board as the Company's board unless and until the incumbents were able to succeed in overturning the election.

Defining independence and conflicts

Returning to Delaware Chancery Court, venBio sought a TRO to prevent the licensing deal with Seattle Genetics from closing. In response, Immunomedics argued that the Seattle deal must go through as it had been approved by four ostensibly independent directors (led by Jason Aryeh) who were properly exercising their fiduciary duty (and being independently advised by Greenhill & Co.) In response, venBio argued that the new directors should not be defined as "independent" due to a web of business relationships with other board members, such as sitting on other boards together and having participated in common transactions.

The opaqueness of the situation made it difficult for shareholders to assess the Seattle Genetics transaction. "The details of the Seattle deal were not publicly disclosed whereas those around a full merger deal would have been made public in the merger agreement," observes Klein. The transaction seemed shareholder-unfriendly partly in allowing only a very short 6 day "go shop" to explore a superior alternative transaction, with a limited number of potential counterparties. Immunomedics was apparently trying to present shareholders with a fait accompli, without giving them full knowledge of the deal terms. However, an independent expert was able to have sight of the Seattle deal terms.

To demonstrate that the Seattle deal offered poor value to shareholders, venBio and SRZ enlisted Locust Walk as an independent expert. One important finding by the expert was that the deal was well below market norms and did not maximize the value of IMMU-132 to the Company's shareholders. In addition, venBio thought that Seattle's option strike price of \$4.90 per share for the

warrants granted to it in the transaction was far too low when venBio estimated the firm's intrinsic value at \$9.40. The expert report teased out the fact that other important information was being withheld from shareholders. When Greenhill tried to rebut the Locust Walk conclusions, it emerged that Greenhill had been offered a success fee of \$1.5 million for defeating the venBio slate (on top of a success fee for the Seattle Genetics transaction closing). This raised doubts about the independence and soundness of Greenhill's advice that shareholders should approve the Seattle licensing agreement. "The hearing transcript, which is publicly available, shows that the judge was very concerned about those conflicts," points out Swartz.

When granting venBio's motion for a TRO to prevent the Seattle Genetics deal from closing, pending a full trial on the merits, the Delaware Chancery Court ruled that even if the board could be defined as independent, that is not sufficient to steamroll through a deal in the context of the entrenchment tactics taken by the board and the banker's conflicts of interest. "Vice Chancellor Laster clarified that Delaware Law is not so formalistic as to automatically allow an independent board to approve anything without giving due consideration to context," says Swartz.

Following the TRO ruling, venBio entered into a settlement agreement with three of the directors, which is subject to court approval and the Company, terminated the Seattle Genetics transaction and entered into a \$125 million financing. The scope of SRZ's practice was drawn upon as other specialists were brought in to advise on areas such as tax, intellectual property and employment, as negotiating severance terms during management and board successions is an important part of the process.

Some litigation is continuing, against four Immunomedics board members for breaches of fiduciary duty, and against Greenhill for aiding and abetting those breaches, in recommending

the Seattle deal. "We were concerned that the bank's conflicts tainted its advice to the board. It is not unusual for a bank to be engaged by the company for a strategic process and for proxy defense advisory work, but we and the court found the presence of success fees for both activities to be surprising," says Klein.

venBio and SRZ achievements

venBio and their advisors attained their near term objectives. They installed venBio's slate of four independent directors and the board is now chaired by venBio's Dr. Aghazadeh. The Company's founder remains on the board but, pursuant to the aforementioned settlement, has relinquished his executive positions while the CEO will step down from both board and management roles. The CFO will serve as interim CEO pending a search for a new CEO. Not only was the Seattle deal halted, but also the exercise period for Seattle's warrants was substantially shortened. The aim is to get IMMU-132 fully approved by 2018 and, partly to this end, \$125 million has been raised in a convertible private placement.

Delaware as a domicile

SRZ notes that Delaware, a frequent US corporate domicile, "is a very good domicile for corporate governance," says Klein. When litigating in Delaware, local counsel are needed, and lawyers from both SRZ and local counsel at Morris, Nichols, Arsht & Tunnell LLP made appearances in the Delaware Chancery Court and Federal Court. The two key judges involved, Vice Chancellor J. Travis Laster in the Chancery Court and Chief Judge Leonard Stark in the Federal Court, were "both excellent and decisive judges who paid close attention to, and well understood, the arguments. It is remarkable how much factual detail both judges absorbed in terms of sifting through highly complex issues in a very expedited time frame," sums up Klein. [THFJ](#)

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