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Lessons for Directors Considering Partnerships with Activists

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Pershing Square Capital Management, L.P. and Valeant Pharmaceuticals International, Inc.'s partnership in pursuit of an acquisition of Allergan, Inc. offers important lessons for directors of potential acquirers who are considering teaming up with activist investors for similar reasons. Takeaways from their experience can help avoid insider trading liability and offer alternate means for acquiring control over a target.

LESSON #1: NOT ALL CO-BIDDERS AND CO-OFFERORS ARE CREATED EQUALLY

Allergan alleged that Pershing and Valeant violated Rule 14e-3, which generally prohibits—after a person has taken "substantial steps" towards commencing a tender offer—non-"offering persons" from trading on material, non-public information relating to a tender offer (*Allergan, Inc. v. Valeant Pharm. Int'l*, 2014 WL 5604539, *6 (C.D. Cal. Nov. 4, 2014)). Parties acting in concert risk insider trading liability when only one party is a true "offering person."

Although Allergan argued that "offering person" can only mean one party, a federal district court in California made it clear that the term can encompass multiple offering persons. Collaborators may take certain steps to minimize potential 14e-3 liability. Although Pershing provided "assistance in strategizing the bid," "financing," and was even listed as an offeror on a Schedule TO, the court found "serious questions" as to whether Pershing was a co-offeror. The court explained that the determination of whether a co-bidder is an offering person for Rule 14e-3 purposes involves analyzing "control factors, such as control over the terms of the offer, control over the surviving entity, and control over and identity with the named bidder."

LESSON #2: ALTERNATIVE TO TENDER OFFERS

The Allergan court did not provide definitive guidance as to the circumstances under which a co-bidder is a co-offeror, and therefore not subject to the insider trading prohibitions of Rule 14e-3. Given that, insider trading liability risk may be too great to engage activists in joint tender offers, despite the utility of tender offers to pressure targets. Moreover, the fact that "substantial steps"—the precursor to implicating the trading prohibitions of Rule 14e-3—are determined by a non-finite list of factors further compounds the risk.

Instead, the activist's acumen in running proxy contests to influence the target's board may prove a lower-risk route. Regulation 14A is less murky and easier to follow than the Regulation 14E guidelines that the Pershing-Valeant partnership allegedly violated. Additionally, the pressure exerted by activists on targets to sell through public campaigns has often proven fruitful in recent history, as highlighted by the successful and lucrative JANA Partners campaign in 2014 at PetSmart, Inc.

The acquirer-activist relationship, however, must still be disclosed during a takeover attempt. Although the Allergan court did not find a violation of Rule 14e-3 (it did not need to make such a finding given the procedural posture of the case), it required Pershing and Valeant to make corrective disclosures pursuant to Rule 14a-9 due to their initial failure to disclose their partnership to Allergan shareholders.



LESSON #3: ACTIVISTS AREN'T FREE

A campaign similar to the Pershing-Valeant operation, in which the activist funded the acquisition of options to purchase 9.7% of Allergan's stock, may be an expensive proposition for bidding companies. Although Pershing's large stake in the tender offer would have provided crucial voting capital and applied pressure on Allergan's board, Pershing, in exchange, enjoyed 85% of the upside on its stake. After all, activists will need an incentive to purchase the significant toehold necessary to apply pressure on the target. Moreover, the price to recruit an activist may remain high—even if the co-offerer helps subsidize the toehold—due to the active measures of involvement that may be necessary.

A bidding company, by examining current Schedule 13D, 13G, and 13F filings to identify potential activist allies for a potential bid, may find significant strategic assistance, voting power, and even a potential rollover equity investor to support a hostile bid. However, given the stakes and scrutiny involved, it is important to be mindful of the lessons offered by this recent situation and approach any such partnership with care given the potentially serious consequences of non-compliance with Rule 14e-3.

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