Broadsides & Bear Hugs: Shareholder Activism and Managing a Hostile Takeover Response

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"Don't worry if you don't know the rules – we're making it up as we go along ..."

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Overview of Hostile Takeovers

- Boards, in the view of fulfilling their fiduciary duties, may reject an offer for a target company for a myriad of reasons.

- If a bidder continues to desire to acquire the company, the bidder may attempt to acquire the company without the approval from the board.

Acquisition Methods

- **Tender Offer**
  - An offer directly to shareholders of a public company to acquire shares of stock.
  - Bidder may be able to take a controlling position.
  - Subsequent merger may be necessary to acquire 100% of stock.
  - May be faster than a proxy contest.
- **Proxy Contest**
  - Used to replace the company's board of directors with new ones that support the dissident's agenda.
  - Time consuming; must be followed by a merger or tender offer.

Takeover Defenses: Poison Pills

- Also referred to as a shareholder rights plan.
- Gives shareholders the right to buy additional stock at a substantial discount.
- Rights are triggered when an acquirer announces the acquisition of or the intention to acquire a certain percentage of stock (often 15% or 20%).
- Poison pill makes completing the acquisition very expenses, as the acquirer’s stock becomes diluted significantly.
- Often may adopt without a stockholder vote because it is akin to declaring a dividend without stockholder approval.

Takeover Defenses: COI and Bylaw Provisions

- Advance notice provisions
- Staggered board
- Special meeting limitations
- Limited size of board
- Elimination of written consent
- Supermajority voting
- Blank-check preferred stock
- Exclusive forum

Takeover Defenses: Statutory

- Delaware: Merger moratorium DGCL 203
- Ohio:
  - Control Share Acquisition Act ORC 1701.831
  - Interested Shareholder Transactions ORC 1704
  - Profit Disgorgement Act ORC 1707.043
  - Control Bid Disclosure Act ORC 1707.041
  - Constituency Statute ORC 1701.59(E)

Fiduciary Duty Framework

Statutory Authority for Duties

- All corporate authority must be exercised by or under the direction of the corporation’s directors
- Certain fundamental decisions affecting the corporation may not be delegated to shareholders
- Ohio General Corporation Law 1701.59(A); Delaware General Corporation Law 141(a)

Statutory Standard

Ohio	Delaware
A director shall perform the director's duties as a director: ➢In good faith; ➢In a manner the director reasonably believes to be in or not opposed to the best interests of the corporation; and ➢With the care of an ordinarily prudent person in a like position under similar circumstances Ohio General Corporation Law 1701.59(B)	No statutory standard; common law governs

Duty of Loyalty

Directors must:

- Put the interests of the corporation and its shareholders ahead of those of the director
- Be disinterested in the matter under consideration and independent in reaching a decision

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Duty of Loyalty

A breach of loyalty case inevitably involves conflicting economic or other interests

- Normally not raised by a mere interest as a shareholder
- Can be raised by compensation issues
- Magnitude of the interest is irrelevant

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Duty of Due Care

- A director must act in an informed and thoughtful manner
- A director must inform himself or herself of all material information reasonably available prior to making a business decision

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Process Is Critically Important

- ✓Act in an orderly manner, without undue haste
- ✓Obtain copies or summaries of key documents in advance of meetings with sufficient time for review
- ✓Ask questions, and ask questions, and ask questions

Reliance on Officers and Experts

- Directors may rely on information, opinions, reports or statements, including financial statements, prepared or presented by:
  - Directors, officers or employees of the corporation whom the directors reasonably believe are reliable and competent in such matters
  - Legal counsel, public accountants or other persons as to matters that the directors reasonably believe are within such person's professional or expert competence

The Business Judgment Rule

- A judicially created presumption that in making a business decision, the directors acted:
  - On an informed basis;
  - In good faith; and
  - In the honest belief that the action taken was in the best interest of the corporation
- Plaintiff must demonstrate that the director breached the duty of care or loyalty to rebut the presumption

Effect of the Business Judgment Rule

Protects directors from second-guessing by courts

- Exceptions for fraud, bad faith, or abuse of discretion

- If a court finds a breach, the burden shifts to the director to prove the intrinsic fairness of the action taken (under Delaware law)

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Breach of Fiduciary Duty

- **Ohio:** Claims that directors have violated their duties require "clear and convincing evidence"
- **Delaware:** Preponderance of the evidence is the applicable standard

Delaware Exculpation

Articles may eliminate or limit a director's personal liability, except:

- Breach of duty of loyalty;
- Acts “not in good faith”;
- Intentional misconduct or knowing violation of law;
- Payment of unlawful dividend or similar transaction;
- Transactions from which the director derives an improper personal benefit

Delaware General Corporation Law 102(b)(7)

Delaware Indemnification

- If a director succeeds, the corporation must indemnify for expenses
- A director may be indemnified by the corporation if the director acted in good faith and in manner the director "reasonably believed to be in or not opposed to the best interests of Corporation"
- Settlement in place of nolo contendre does not, by itself, create a presumption otherwise
- If a derivative action, then the director cannot be indemnified if the director is adjudged to be liable to the corporation (unless approved by the court)
- The corporation may advance expenses if the director undertakes to repay such advances if the director is ultimately not entitled

Delaware General Corporation Law 102(b)(7)

Ohio "Exculpation"

- Unless the articles or regulation opt out, no monetary liability for directors unless
  - Clear and convincing evidence
  - Act or failure to act
    - Involved an act or omission undertaken with deliberate intent to cause injury to the corporation, or
    - Was undertaken with reckless disregard for the best interests of the corporation
- No specific exceptions

Ohio General Corporation Law 1701.59(D)

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Ohio Indemnification

- If a director succeeds on the merits, the corporation <u>must</u> indemnify for expenses; unless the corporation opts out, the corporation must advance expenses (subject to repayment)

- A director <u>may</u> be indemnified by the corporation if the director acted in good faith and in manner the director "reasonably believed to be in or not opposed to the best interests of Corporation"

- If a derivative action, then the director cannot be indemnified if:

  - The director is adjudged to be liable for negligence or misconduct in the performance of the director's duty to the corporation (unless approved by the court)

  - The only liability asserted relates to an unlawful dividend or similar transaction

Ohio General Corporation Law 1701.13(E)

Unocal Enhanced Scrutiny

- Heightened Unocal test applies when a board adopts a defensive measure in response to a takeover attempt because of inherent conflicts of interest.
- If measures are adopted on a "clear day," Unocal does not apply and BJR applies.
- Test: Directors must show:
  - Reasonable grounds for believing a danger to corporate policy and effectiveness existed (reasonableness test);
  - The defensive measure was reasonable in relation to the threat (proportionality test).
- Boards should ensure a reasonable and good faith investigation by independent directors before adopting defensive measures.

Revlon Increased Scrutiny

- Triggered when the board has decided to sell or a sale becomes inevitable.
- In a change of control transaction, boards of directors have the burden of achieving the highest value reasonably available.
- If directors do not meet burden, then must show the transaction was entirely fair to the corporation.

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Ohio Stakeholder Statute

- The director ***shall*** consider the interests of the corporation's shareholders; and
- In the director's discretion, the director ***may*** consider any of the following:
  - Interests of employees, suppliers, creditors, and customers
  - Economy of the state and nation
  - Community and society
  - Long-term and short-term interests

Ohio General Corporation Law 1701.59(F)


ESSENTIALS OF RISK MANAGEMENT:
1. DON'T DO ANYTHING WRONG TODAY.
2. DON'T DO ANYTHING WRONG TOMORROW.
3. REPEAT.
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