Market Trends 2019/20: Hostile Takeovers and Proxy Contests

A Practical Guidance® Practice Note by
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This practice note discusses recent market trends regarding hostile takeovers and proxy contests that practitioners should be aware of, including recent notable transactions and explains what hostile takeovers and proxy contests are and how they are conducted and the current legal and regulatory environment.

For additional information on proxy contests, see Proxy Contest Preparation and Proxy Statement and Annual Meeting Resource Kit. For other market trends articles covering various capital markets and corporate governance topics, see Market Trends.

As mergers and acquisitions (M&A) activity continued to be high in 2019, hostile takeovers and proxy contests for corporate control of public companies also remained popular. In the first half of 2020, the coronavirus pandemic and the resulting stock market volatility and economic recession drastically changed the dynamics in the market for corporate control. Uncertainty, operational challenges and liquidity pressures made corporate acquirers less willing to pursue hostile deals in the current environment. On the other hand, the stock market drop created opportunities for the corporate raiders, private equity groups and activists who had accumulated substantial amounts of "dry powder."

Notable Transactions

Some of the most notable recent transactions are discussed below.

- **Carl Icahn and Darwin Deason's replacement of Xerox's management.** On January 22, 2018, activist investors Carl Icahn (Icahn) and Darwin Deason (Deason), together owning roughly 15% of Xerox Corporation's (Xerox) common stock, announced they would jointly attempt to elect four directors at an upcoming annual meeting of Xerox. Following such announcement, on January 31, 2018, Xerox and Fujifilm Holdings Corporation (Fujifilm) publicly announced an agreement whereby Fujifilm would acquire Xerox for roughly $6.1 billion with Xerox shareholders receiving a special cash dividend of $2.5 billion.

  On February 13, 2018, Deason filed suit against Fujifilm and Xerox seeking to prevent the transaction on the basis that it was a result of a crown jewel lockup right created by previously entered into joint venture agreements between Fujifilm and Xerox. Among other things, Deason alleged that such agreements gave Fujifilm control over certain of Xerox's intellectual property and manufacturing rights in the Asia-Pacific market if Xerox sold a 30% stake to another potential acquirer. Deason later also indicated an intent to nominate a full slate of directors to Xerox's board. Xerox responded by taking the position that Deason's proposed directors cannot be nominated unless done in compliance with the advance notice provisions in Xerox's bylaws. As a result, Deason filed a second lawsuit in New York courts on March 2, 2018, seeking to enjoin Xerox from enforcing such advance notice provisions on the basis that the proposed transaction constituted a change in circumstances that was announced after Xerox's advance notice provisions' nomination deadline. Adopting the Delaware Court of Chancery's view in Hubbard v. Hollywood Park Realty Enters. Inc., the New York State Supreme Court declined to enforce Xerox's advance notice provisions and granted a preliminary injunction of the change of control transaction between Xerox and Fujifilm (the injunction was later reversed). Shortly thereafter, Xerox, Icahn, and Deason entered into a settlement agreement requiring the resignation of Xerox's CEO and the replacement of several Xerox board members.

Xerox has since unilaterally terminated its transaction with Fujifilm. As a consequence, Fujifilm has filed suit against Xerox seeking $1 billion in damages. In November 2019, Xerox and Fujifilm reached a settlement that will see Xerox sell some of its assets to Fujifilm for $2.3 billion.

- **Xerox's attempted takeover of Hewlett-Packard.** In November 2019, Carl Icahn, who owned a 10.6% stake in Xerox, announced that he owns a 4.24% stake in Hewlett-Packard. At the same time, Xerox approached the board of Hewlett-Packard with an offer to merge the two companies. The offer valued Hewlett-Packard at $33.5 billion and was firmly rejected by Hewlett-Packard. On January 23, 2020, Xerox announced that it planned to nominate 11 new directors to replace Hewlett-Packard's entire board of directors at an upcoming shareholder meeting. Subsequently, on March 2, 2020, Xerox launched a formal tender offer for Hewlett-Packard's shares. However, with the coronavirus pandemic affecting the operations and the stock price of both companies, on March 31, 2020, Xerox terminated the tender offer and ceased attempts to take over Hewlett-Packard.
- **Merck's successful takeover bid for Versum.** While Versum Materials Inc. (Versum) was in the process of implementing an all-stock merger with Entegris Inc. (Entegris), in February 2019, Merck KGaA (Merck) approached Versum with a proposal for an all-cash acquisition, which the board of Versum rejected. In March 2019, Merck launched a tender offer for Versum's stock and in parallel solicited proxies to vote against the all-stock merger of Versum and Entegris. Subsequently, Merck increased its bid from $48 per share to $53 per share, which prompted the board of Versum to recognize such improved offer as a superior proposal as compared to the transaction with Entegris. On April 12, 2019, Versum terminated the merger agreement with Entegris and entered into a merger agreement with Merck, which the shareholders of Versum approved on June 17, 2019.
- **Broadcom's attempted takeover of Qualcomm.** On November 6, 2017, Singapore-based Broadcom Limited (Broadcom) submitted an unsolicited proposal to acquire U.S. chip maker Qualcomm Incorporated (Qualcomm) for a combination of cash and stock initially valued at roughly $117 billion, which was rejected by Qualcomm's board. Broadcom eventually notified Qualcomm of its intention to nominate 11 independent directors to replace Qualcomm's entire existing board at Qualcomm's upcoming annual meeting scheduled to occur on March 6, 2018. In response, Qualcomm's board encouraged shareholders to reject Broadcom's nominee slate. Two days prior to Qualcomm's scheduled annual meeting, the Committee on Foreign Investment in the United States (CFIUS) ordered that Qualcomm's stockholder meeting be delayed for 30 days. On March 12, 2018, U.S. President Trump, after reviewing CFIUS's recommendation encouraging the enjoinment of the transaction, issued an order blocking the takeover. His order stated there was credible evidence that Broadcom might take action that threatens to impair the national security of the United States. Notably, on June 8, 2018, a proposed securities class action suit was filed in the U.S. District Court for the Southern District of California against Qualcomm and certain other defendants alleging that defendants made materially false and misleading statements and failed to disclose to investors that Qualcomm had secretly filed a unilateral notice with CFIUS in order to frustrate Broadcom's attempt to acquire the company (Camp v. Qualcomm Inc. et al.). On March 10, 2020, the federal judge tossed some of the claims in that proposed shareholder class action. Furthermore, on March 8, 2018, a proposed class action suit was filed in the Chancery Court of Delaware against Qualcomm and certain other defendants alleging that by inviting CFIUS to review the deal, the directors of Qualcomm violated their fiduciary duties (Evans v. Qualcomm Inc.). Subsequently, the plaintiff voluntarily dismissed the complaint without prejudice.
- **Bow Street's overture for the assets of Mack-Cali.** On February 25, 2019, Mack-Cali Realty Corporation (Mack-Cali) received an unsolicited proposal from Bow Street Special Opportunities Fund XV, LP (Bow Street) to acquire for cash Mack-Cali's suburban and waterfront office assets in a complex transaction in which the remaining residential assets of Mack-Cali would be spun-off to Mack-Cali stockholders. Bow

Street held approximately 4.5% of Mack-Cali's stock. The board of Mack-Cali rejected the proposal, and Bow Street nominated a slate of candidates to Mack-Cali's board. After settlement negotiations between Mack-Cali and Bow Street fell through and the proxy advisors recommended voting for the nominees of Bow Street, on June 12, 2019, Mack-Cali announced that it withdrew the nominations of its four incumbent directors resulting in the election of Bow Street's nominees to the board (importantly, the move allowed the incumbent chairman William Mack retain his board seat). Mack-Cali also announced that it intends to form a committee to review strategic alternatives, as well as dismantle certain takeover defenses, namely, opt out of Maryland's anti-takeover statute and rescind the agreement that lets the Mack family nominate up to three directors to the Mack-Cali board. The saga continued during the 2020 proxy season. Mack-Cali decided not to nominate the four directors elected in 2019, and Bow Street advanced a slate of eight director nominees. Proxy advisory firms recommended that Mack-Cali shareholders elect as least five of Bow Street's eight nominees. On June 10, 2020, Mack-Cali postponed its shareholder meeting until further notice as it continues talks with Bow Street.

- **Rice brothers' contest for control of EQT.** EQT Corporation (EQT) acquired Rice Energy Inc. in November 2017. In December 2018, Toby Rice and Derek Rice, who held approximately 3.1% of EQT's stock, expressed their dissatisfaction with EQT's operational performance and proposed to implement a transformation plan at EQT, as well as to reconstitute the EQT board and appoint Toby Rice as the EQT CEO. After some engagement with the Rice brothers, in January 2019, EQT announced various plans and actions to maximize shareholder value. On March 21, 2019, the Rice brothers nominated a majority slate of nine candidates for election at the EQT 2019 annual meeting. On July 10, shareholders overwhelmingly voted to hand over control of EQT to the Rice brothers. Interestingly, this proxy fight involved the use of a universal proxy card—all company nominees and Rice brothers' nominees appeared on each side's proxy cards, which allowed the shareholders to pick and choose the best director candidates from among those nominated by each side. This was the first ever use of a universal proxy card in a contested election involving a control slate of directors.

Deal Structure and Process

General Background

A hostile takeover is a purchaser's acquisition of a public company against the wishes of such public company's incumbent board of directors. Generally, purchasers in this context are referred to as hostile acquirers or hostile bidders. Hostile acquirers may include, among others, competitors of the target company.

Hostile takeovers continue to constitute a significant portion of the M&A market. In 2017, hostile takeovers reportedly accounted for $575 billion worth of acquisition bids, or about 15% of 2017's total M&A volume. Despite this, hostile takeovers are rarely the preferred means towards acquiring a target company. Among other things, a failed hostile takeover may:

- Taint the dealmaking track record of the hostile bidder or allow the target company to be acquired by a competitor (e.g., in the case of a white knight scenario as discussed further below)
- Encourage the target company to engage in a public campaign against the hostile bidder that may create doubt with respect to such hostile bidder's accounting practices, growth prospects, or the sustainability of such bidder's business if a hostile bidder offers its own shares as consideration
- Result in significant transaction expenses in the form of advisor and/or regulatory compliance fees and carry increased risk as hostile acquirers navigate applicable legal, regulatory, and other pitfalls –or–
- Require hostile acquirers to purchase the target company's shares at substantial premium prices in order to convince shareholders to tender shares contrary to board recommendations

This all makes hostile takeovers difficult to successfully consummate. With respect to proxy fights specifically, of the reported fights that went to a shareholder vote in 2017, the target company's management emerged victorious in 53% of cases (as compared to 69% in 2016 and 55% in 2015). Hence, market trends indicate that when it comes to a vote, the shareholders' support for activists is far from certain. Nevertheless, you or your client may still choose to pursue a hostile takeover for a variety of reasons, including:

- Strategic considerations, such as significant synergies between the target company and the bidder that outweigh the increased risks and costs of proceeding with the hostile takeover
- The bidder's belief that the target company's board of directors and upper management are not delivering sufficient shareholder value and that shareholders of the target company may be susceptible to a hostile offer –or–
- In an activist shareholder scenario, an acquirer's general desire to replace the target company's board of directors and upper management

Proxy Contests and Tender Offers as Forms of a Hostile Offer

Hostile takeovers in the United States usually involve a proxy contest that seeks to replace the board of a target company. This also may involve a hostile acquirer conducting a tender offer to purchase a target company's shares in order to increase such acquirer's voting power to replace such target company's directors during a proxy contest. If the proxy contest is successful, the (now) friendly board of the target company would engage in a negotiated transaction with the bidder. Such negotiated transaction may take the form of another tender offer followed by a merger without a shareholder vote, a long-form merger with a shareholder vote, or other various M&A structures. For further information on tender offers, see Tender Offers Distinctive Characteristics and Market Trends 2019/20: Tender and Exchange Offers. For more information on Proxy Contests, see Proxy Contest Preparation.

How Proxy Contests Work

A proxy contest, also referred to as a proxy fight or a proxy battle, is a contest for votes of a target company's shareholders (also known as proxies) in order to win a shareholder vote on a certain matter. In a proxy contest, a shareholder or a group of shareholders of a company typically solicit proxies in opposition to the recommendation of a target company's board. In a hostile takeover scenario, a hostile bidder engages in a proxy contest and attempts to persuade the target company's shareholders to elect new directors (normally, the bidder's nominees) who are friendly to the takeover. A credible threat of a successful proxy contest alone may force the incumbent directors of a target company to engage in negotiations with a hostile bidder.

In a proxy contest, a dissident shareholder or a group of shareholders nominates a competing slate of director candidates for election and solicits votes in support of such nominees. The dissident shareholder may nominate a short (or minority) slate, control (or majority) slate, or full slate of directors. With respect to a majority or full slate, if elected, the nominees form the majority or the entire board, and the dissident (or hostile bidder) typically obtains the ability to, among other things, disable poison pills and other anti-takeover defenses or engage in a negotiated transaction for the sale of the company. Passive investors and proxy advisory firms view short slates as less disruptive and, therefore, may more readily vote in favor of them. Nevertheless, given their lack of decisive influence, a bidder in a hostile takeover would usually choose to advance a majority or full slate. Short slates are more common in shareholder activism situations, even though recently activists advanced majority slates more frequently. In many cases activists pursued such strategy, at least in part, to better position themselves in settlement negotiations with the incumbent management. For example, in 2019, activist investor Starboard Value nominated three control slates at Magellan Health, GCP Applied Technologies, and Dollar Tree, but ultimately withdrew or settled for just a few director seats. By contrast, in 2020, Starboard Value again advanced a majority slate at GCP Applied Technologies and saw its nominees elected to the majority of director positions.

Regulatory Environment for Proxy Contests and Disclosure Trends

Proxy Rules

Proxy contests are regulated by federal and state laws as well as stock exchange rules. Generally, shareholders cast their votes at annual or special meetings of shareholders. Since most shareholders do not physically attend the meetings, they are permitted to vote through proxies.

Proxy solicitations and dissemination of solicitation materials to shareholders are subject to regulation by Section 14 of and Regulation 14A under the Securities Exchange Act of 1934, as amended (the Exchange Act). Proxy rules define solicitation of proxies very broadly to include "communication[s] [. . .] reasonably calculated to result in the procurement, withholding or revocation of a proxy" (Rule 14a-1(l)(1)(iii)). Subject to limited exceptions, the solicitation of proxies is generally allowed when the solicited party is concurrently furnished or has previously been furnished with a proxy statement filed with and approved by the U.S. Securities and Exchange Commission (SEC). Certain types of solicitation communications other than proxy statements are nevertheless allowed prior to the furnishing of the proxy statement and without preapproval by the SEC. Such materials must be filed with the SEC on the same date as their dissemination and must comply with certain other requirements (such communications may include press releases, social media posts, other publications, letters, and emails).

To solicit proxies in favor of its competing directors, the dissident shareholder must file its preliminary proxy statement and proxy card with the SEC at least 10 days prior to the date when the definitive proxy statement and proxy card are first distributed to other shareholders. In a contested election, the target company would also go through the process of filing a preliminary proxy statement and proxy card. After the SEC completes its review of the preliminary proxy statement and the proxy card of both the company and the dissident shareholder, the definitive proxy statement and proxy card may be filed with the SEC and distributed to shareholders.

Among other things, the definitive proxy statement should generally discuss the items to be voted on, voting procedures, and director and officer information. The definitive proxy statement and proxy card generally **do not** include an in-depth discussion of the hostile acquirer's actual campaign platform. Rather, the core arguments and theme statements of any given issue presented are typically discussed in so-called fight letters, which are letters disseminated after the definitive proxy statement and proxy card are reviewed by the SEC. Fight letters constitute additional definitive materials and, although they need to be filed with the SEC upon their first use, are not subject to preapproval by the SEC. To make fight letters more persuasive, dissident shareholders often include or discuss qualitative and quantitative historical performance data, statistical information in relation to past performance shortfalls, any perceived flaws in board composition or process, failed transactions, executive compensation in relation to the corporation's performance, any related party transactions, any corporate governance weaknesses, and other red flag issues associated with the target company's performance or nominees.

In the takeover bid scenario, a fight letter may also include a discussion of how the sale of the company is superior to other strategic alternatives available to the shareholders of the target company. If there is no alternative takeover bid, the campaigning hostile bidder or dissident shareholder may also describe its plans for improving the financial results and increasing the share value of the target company as a result of replacing the board. If a proxy advisory firm supports the slate of directors advanced by the hostile bidder or dissident shareholder, the fight letter would typically include a statement that the authoritative proxy advisory firm recommends replacing the board with the competing slate of candidates. While fight letters are intended to sway shareholders and are often less formal than proxy statements, dissident shareholders and hostile bidders should be mindful of the antifraud provisions of the proxy rules. Specifically, fight letters and similar communications may not overstate, understate, or provide misleading information.

Voting Standards in Director Elections

State corporate laws and corporate charters determine the vote needed to elect directors, such as plurality (and its variations) or majority voting. Traditionally, the plurality vote standard results in the election of those directors who receive the most votes. Over the last decade, however, the majority voting standard has received widespread acceptance. It contemplates that the directors who obtain a majority of the votes of the shareholders are elected, and if any incumbent directors do not receive a majority of the votes, such incumbent directors hold over in their positions even if other nominees, who failed to receive majority support, received more votes than such incumbent directors. For this reason, the majority voting standard was intended for use in uncontested director elections, and the corporate charters of most corporations using such standard provide an exception requiring the use of the plurality standard in contested elections. However, by 2015, 13.9% of companies using the majority voting standard did not maintain a contested election exception in their charters. Institutional Shareholder Services (ISS), an influential proxy advisory firm, characterized such design as a potential entrenchment device.

The SEC has recently become concerned with the accuracy of disclosures of election standards in proxy statements, with SEC staff identifying the following ambiguities and inaccuracies in the disclosures of voting standards: the failure to include an **against** option on the form of proxy when a majority voting standard is used, the mistaken use of the **against** option on a form of proxy when there was a plurality voting standard and where the only appropriate alternative for voting was **withhold**, and incorrect statements that **withhold** votes are counted in determining election outcomes. Boards and dissident shareholders should be mindful of these issues when preparing proxy statements and proxy cards.

How Tender Offers Work

Prior to, during, or independently of a proxy contest, a hostile acquirer may conduct a hostile tender offer by purchasing a target company's shares from other shareholders against the wishes of such target company's board. A hostile acquirer may do this by launching, directly to such target company's shareholders, a bid to purchase a sufficient number of such target company's shares as needed to replace its board of directors. Upon successfully purchasing such shares, the hostile acquirer may use the voting power of such shares to replace all or a portion of the target company's directors, as needed, opposing the takeover with friendly directors who will vote in favor of accepting the (previously hostile) bid.

Regulatory Environment for Tender Offers

During a tender offer, a bidder should be mindful of various regulatory requirements. Sections 13(d) and 13(g) of the Exchange Act, for example, generally require investors to file a Schedule 13D or Schedule 13G, as applicable, with the SEC within 10 days after acquiring more than 5% beneficial ownership of a voting class of a target company's registered equity securities. Among other things, it discloses the investor's identity, purpose for investment, source of consideration, and other material information for the public.

Once a hostile bidder commences a tender offer for more than 5% beneficial ownership of a class of a registered equity security, Regulation 14D of the Exchange Act imposes filing, disclosure, and dissemination requirements. A bidder must send the SEC, the target company, and any competing bidders a Schedule TO as soon as practicable on the date of the commencement of the tender offer. A Schedule TO provides an overview of certain material matters with respect to the tender offer including, but not limited to, the terms of the offer and information about the bidder's identity and intent. The contents and the scope of the disclosures in a Schedule TO are guided by reference to Regulation M-A. After its commencement, a tender offer must remain open for at least 20 business days and, after certain material changes, typically for an additional 10 business days. A hostile bidder must ordinarily provide the SEC and shareholders amended information upon material changes in the tender offer. At the end of the tender offer period, a hostile bidder must promptly provide the SEC a final amendment to the Schedule TO that reports the results.

In response to a tender offer, a target company must prepare a Schedule 14D-9 describing the target company board's position with respect to such tender offer. Within 10 business days of the tender offer's commencement, the target company must provide the Schedule 14D-9 to shareholders, the SEC, and any national securities exchange on which the class of securities is registered, if any. Amendments to the Schedule 14D-9, such as negotiations with a white knight, must be filed promptly with or provided to, as applicable, shareholders, the SEC, and national stock exchanges.

Strategies for Commencing a Hostile Takeover

Hostile takeovers may be initiated in a variety of ways depending on the bidder's specific strategic considerations. These include:

- **Casual contact.** Acquiring a company without support of its board of directors is difficult. Normally, a potential acquirer would probe the incumbent board's willingness to engage in a negotiated transaction by having its officers or directors casually discuss the possibility of the transaction with an officer or director of the target company.
- **Bear hug letters.** A hostile acquirer may submit a private bear hug letter to the target company's CEO and/or board of directors. Such letter would state the hostile acquirer's desire to acquire the target company and request a friendly negotiation. It often also includes an explicit threat to proceed with a hostile takeover if the board or upper management refuses to negotiate. If the target company refuses, the (now) hostile acquirer may publicly file the bear hug letter to formally alert the target company and its shareholders of the hostile acquirer's desire to acquire the target at a certain price (e.g., on May 21, 2019, Crane Co. (Crane), an industrial products manufacturer, publicly announced that CIRCOR International, Inc., its competitor, had rejected the $896 million acquisition offer that Crane privately submitted earlier).
- **Launching a proxy contest or tender offer without bear hug letter.** In an extreme situation where the bidder concludes that engagement with the target board would be futile, it may opt to start the process by first launching a proxy contest or tender offer. Proxy contests may be initiated in preparation for a special or annual meeting of the target company's shareholders or, if the target company's charter allows, through action by written consent. Tender offers may be initiated by complying with the regulatory requirements set forth in the Exchange Act, as already discussed above.
- **Topping bids.** In some cases, a potential acquirer (friendly or hostile) may have already launched a tender offer to purchase a target company. A hostile acquirer may then attempt to submit a topping bid, or a competing bid to the target company's board and/or shareholders to purchase the target company (usually for more consideration). While topping bids were an active means towards pursuing a hostile takeover, they often increase the costs of acquiring the target company. Among other reasons, this can be due to a hostile bidder agreeing to, if successful, incur a target company's termination fee that becomes due under the target company's

previously agreed-upon transaction agreement. Usually though, it is because topping bids increase the risk of bidding wars between potential acquirers (e.g., a bidding war unraveled when The Walt Disney Company and Comcast Corp. competed for the assets of Twenty-First Century Fox, Inc. in the second half of 2018). In April 2019, the proposed acquisition of Anadarko Petroleum Corp. (Anadarko) by Chevron Corp. (Chevron) became an example of a transaction where the interloper making a topping bid prevailed. Occidental Petroleum Corp. (Occidental), after securing a $10 billion investment from Berkshire Hathaway Inc., made a $38 billion superior proposal to acquire Anadarko, which topped the $33 billion price under the agreement between Anadarko and Chevron. Accordingly, Anadarko terminated its agreement with Chevron and entered into a merger agreement with Occidental.

Takeover Defenses and Delaware's Standards of Review for Board Actions

Boards generally are allowed wide latitude to employ takeover defenses to fend off hostile bids. These include:

- **Shareholders' rights plans or poison pills.** Commonly known as poison pills, shareholders' rights plans typically allow all shareholders of a target company (except a hostile acquirer) to purchase additional shares of such target company at a significantly discounted rate upon a triggering event. Such triggering event usually takes the form of any shareholder accumulating a certain percentage of the target company's outstanding shares without the target board's cooperation. This results in the acquisition of the target company becoming prohibitively expensive for the bidder. Recent market data shows that the number of active poison pills has significantly dropped. This is largely due to shareholder resistance against poison pills in the current market unless they are instituted subject to shareholder approval. On this and similar bases, many companies have allowed their poison pills to expire or have had them affirmatively terminated. At one point, at least 3,000 companies reportedly had a poison pill in place, including 60% of companies constituting the S&P 500. As of 2018, that number has dwindled to over 300 U.S. companies, including roughly 3% of the S&P 500. These statistics may nevertheless be deceiving given a poison pill, if needed, can be adopted by a board overnight. Companies today may even leave their poison pills on the shelf, having already been drafted and approved by the target company's board and ready to be deployed in little time. For example, in the wake of stock price declines cause by coronavirus in 2020 companies turned to poison pills to protect against unauthorized accumulations of their stock. Quite a few companies deployed poison pills in the first weeks of the crisis (e.g., energy companies Occidental Petroleum and Williams Companies). Recently, companies have been using poison pills with lower trigger caps to fend off activist hedge funds (see Third Point LLC v. Ruprecht, et al., C.A. No. 9469-VCP (Del. Ch. May 2, 2014), where the Delaware Court of Chancery upheld the use of a poison pill that would be triggered by a bidder accumulating as little as 10% of the target company's shares). For further information, see Shareholder Rights Plans and Poison Pills: Fiduciary, Filing, and Disclosure Obligations.
- **Staggered boards.** Staggered board defenses are provisions in a target company's charter that only allow certain seats on a target company's board of directors to go up for election in any given year. This prevents a hostile acquirer from being able to replace a majority of a target company's board in any single year or at any single annual shareholder's meeting. In the landmark case resulting from the failed takeover attempt of Airgas, Inc. by Air Products & Chemicals, Inc., a combination of a staggered board and a poison pill proved to be one of the most effective takeover defense strategies, the legality of which was validated by the Delaware Court of Chancery (see Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48 (2011 Del. Ch.)). Investors, however, tend to disfavor staggered boards in the current market because of their potential to entrench boards. In this vein, shareholders continue submitting proposals requesting companies to repeal staggered board provisions. Since 2005, at S&P 500 companies, such proposals have passed overwhelmingly. According to a study by ISS, in 2017, only 13% of the S&P 500 companies had staggered boards with multiyear terms. However, in smaller companies staggered boards with multiyear terms remain much more prevalent—38% of S&P 400 companies and 47% of S&P 600 companies have such staggered board provisions.
- **State anti-takeover statutes.** State anti-takeover statutes are statutes adopted by various states that seek to protect target companies against unwanted corporate takeovers. Target companies usually have the ability to opt out of or not opt in to such statutes in their charters and most do. In the current market, state anti-takeover statutes continue to remain a relevant takeover defense. In 2016, for example, The Andersons Inc., an Ohio corporation, publicly emphasized that it would not adopt a poison pill in the face of a takeover attempt by HC2 Holdings, Inc. Instead, it relied on its state of incorporation's anti-takeover statutes.

The state of Delaware's anti-takeover statute restricts a business combination by a target company and an interested shareholder except in certain situations (see DGCL § 203). One exception, for example, if the target's company's board and the holders of two-thirds (66 2/3%) of such company's voting stock (excluding the interested shareholder) approve the business combination. Delaware corporations may opt out of DGCL § 203 by expressly stating so in their certificates of incorporation or any subsequent amendments to their certificates of incorporation or bylaws.

- **Advance notice provisions.** Advance notice provisions in a target company's bylaws require shareholders to provide advance notice to the target company's board of directors with respect to certain items that such shareholder seeks to discuss at an upcoming shareholder's meeting. These items typically include board nominations. This notice requirement serves to inform a target company's board of any impending board nominations and provides the board with more time to prepare and counter such proposals.
- **Reporting hostile bids to regulators.** Some companies targeted by a hostile bidder have tried to oppose the takeover attempts by hindering the hostile bidder's chances of obtaining regulatory clearances for the acquisition, especially the antitrust clearances (e.g., the board of Qualcomm allegedly tipped off CFIUS to security concerns trying to fend off Broadcom). However, as discussed above, such a strategy may backfire, as such actions of the target's directors may violate their fiduciary duties. Once the regulatory scrutiny is invited, sale of the company becomes difficult to implement even when the bidder raises the bid price and the board of the target wants to proceed with the takeover.
- **Alternative offers from white knights and the use of white squires.** If possible, a board of a target company may attempt fending off a hostile acquirer by soliciting a bid from a board-preferred friendly acquirer. Such friendly acquirer is often referred to as a white knight. Once a board solicits a competing bid to purchase the target company, it must comply with its *Revlon* duties (as discussed below) and ensure that the accepted bid provides the greatest immediate value to its shareholders. While difficult to successfully consummate, the use of white knights still occurs in the current market landscape. In September of 2018, for example, the authors advised Zijin Mining Group Co., Ltd., a Chinese gold and base metals producer, as it served as a white knight to successfully complete a friendly takeover of Nevsun Resources Ltd. (Nevsun). The competitive deal was valued at roughly $1.41 billion, and arose off the heels of various hostile bids from Nevsun's rival Lundin Mining Corp. whose offers, according to Nevsun's board, undervalued Nevsun and its assets.

  As an alternative to a full acquisition, a board may encourage an existing friendly shareholder to purchase a noncontrolling block of voting shares in the target company (usually up to 19.9% of the target company's shares to avoid shareholder vote requirements under the rules of certain securities exchanges). Such shareholder, known as a white squire, would then use its shares to vote in favor of board decisions. Alternatively, a number of friendly shareholders may enter into a voting agreement with the company committing to support the board. For example, after Origin House, a cannabis company, received unsolicited offers from several unnamed suitors, in January 2019, its shareholders representing approximately 26% of the stock entered into voluntary voting support agreements with the company.

Upon shareholder challenge, Delaware courts will generally apply the business judgment rule when evaluating whether a corporate board has violated its fiduciary duties by taking any specific action. The business judgment rule creates a presumption in favor of the board's action and may generally only be rebutted if the challenging shareholder can show that the challenged actions of the directors were not made (1) in good faith, (2) with reasonably prudent care, or (3) with a belief to be in the best interests of the corporation.

Delaware courts will nevertheless exercise enhanced scrutiny when reviewing whether a target company's board of directors has complied with its fiduciary duties when adopting takeover defenses. The relevant standards of review were originally set forth in Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) and Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). The more deferential *Unocal* standard is primarily used to assess a board's employment of takeover defenses when the board intends to preserve the stand-alone identity of the company. Under the *Unocal* standard, a board will be viewed to have complied with its fiduciary duties if it can show that the actions of its directors (and the implemented takeover defenses) were (1) made in good faith after reasonable investigation in concluding there was a danger to corporate policy and effectiveness and (2) reasonable in relation to the threat posed. However, once a board decides to sell a company (e.g., to a white knight) or otherwise agrees to a change of control, the heightened *Revlon* standard of review applies.

Under *Revlon*, Delaware courts will require (1) boards to focus on delivering the highest short-term financial value to shareholders rather than the board's perceived long-term value of the proposed offer to the company and (2) upon a challenge of a board's decisions by shareholders, that the board's choices be reviewed with a heightened scrutiny standard that exceeds the business judgment rule. Specifically, the disinterested and independent board must prove that its decision-making process was (1) performed with adequate care and (2) reasonable under the circumstances.

Strategies in Soliciting Support of Different Investor Groups

During a hostile takeover, you or your client may employ various techniques to engage investor groups in target companies. Knowledge of shareholder bases becomes pivotal in such situations. Typically, such investor groups include the following:

- **Activist investors.** Activist investors are individuals or groups obtaining large amounts of a company's shares in order to effect major corporate changes. As a means towards cashing out and profiting from their investments, activist investors frequently favor M&A transactions with respect to the sales of the target companies in which they are invested. Sometimes such activists, using a wolf pack strategy, create informal alliances and together invest in a target in order to exert significant influence (as occurred when Icahn and Deason joined forces to replace Xerox's management, as discussed above). In a hostile takeover scenario, activist investors may pressure an incumbent board to engage in negotiations or support a hostile bidder. On the other hand, influential activists may engage in a tactic known as bumpitrage and threaten to hold out or otherwise frustrate a takeover attempt by a hostile bidder if such bidder does not increase its offered price. According to data published by SharkRepellent, in 2019, proxy season activists publicly opposed transactions on 63 occasions, an increase of 58% from five proxy seasons ago.

  Activists may alternatively encourage other shareholders to replace a company's board altogether simply to effect corporate change. Interestingly, in the past few years, some of the activist investors have been successful in mastering the private equity playbook (e.g., Elliott Management has done a number of deals at the intersection of activism and private equity). For further information, see Shareholder Activism and Engagement in International Jurisdictions.

- **Passive investors.** Major index fund providers, such as BlackRock, State Street, and Vanguard, own massive amounts of shares in public companies, but have historically taken a passive approach to voting such shares. Because large index funds own 5%–20% of most public companies, they are frequently invested in opposing parties in a hostile deal. They therefore tend to exercise a pragmatic approach by evaluating each deal's synergies and the value-creating potential of the proposed transactions. On the other hand, activist investors (who often constitute hostile bidders) may have relationships with large index funds and be better positioned than an incumbent target company board to obtain support.

- **Proxy advisory firms.** Although they are not shareholders themselves, proxy advisory firms such as Glass Lewis and ISS possess significant influence over the results of a proxy contest by making voting recommendations to their subscribers (in particular, various investment advisers who continue relying on the recommendations of the proxy advisors to avoid liability under Rule 206(4)-6 under the Investment Advisers Act of 1940). Roughly a decade ago, the investment community expressed concern that proxy advisory firms would become super-governance institutions positioned to have the final say in virtually all hostile transaction scenarios. Although proxy advisory firms continue having a significant influence on hostile transactions, their support is not dispositive of outcomes. While large index funds take recommendations of proxy advisors into account when deciding how to vote, such funds are increasingly relying on their own internal evaluations. For example, in a proxy fight for control of the board of GCP Applied Technologies in 2020, Starboard Value prevailed notwithstanding Glass Lewis's recommendation to vote for the incumbent directors (although ISS recommended voting for the activist's nominees). Nevertheless, in 2019, the SEC initiated changes purporting to regulate proxy advisors, as discussed below.

- **Other investor groups.** Other investor groups influential to the outcome of a hostile takeover may include transaction-friendly arbitrageurs who purchase a target company's shares prior to a transaction with an expectation of making a profit post-transaction; legacy shareholders (e.g., a target company's founding family), who tend to favor the target company's historical management; and executive officers, in addition to other management and employees of the target company, who may hold significant amounts of shares through executive compensation or pension plans.

Legal and Regulatory Trends

Several recent developments in the legal and regulatory environment surrounding hostile takeovers may have far reaching consequences for the strategies and tactics that you or your client may employ. These include:

- **Shift to virtual shareholder meetings.** Virtual shareholder meetings were first permitted by the Delaware General Corporation Law in 2000. However, the investor community cautioned against the virtual-only meetings, and companies were slow to switch to the virtual-only mode. However, due to the lockdowns caused by the coronavirus pandemic, most companies held their 2020 shareholder meetings virtually, many of them for the first time. To make the process easier, in April 2020, the governor of Delaware issued an emergency order allowing corporations to switch from a noticed in-person meeting to a virtual meeting and to adjourn a noticed in-person meeting to a later dated virtual meeting if necessary to address the health concerns presented the coronavirus pandemic. Furthermore, 2020 saw a first ever contested director election held at a virtual shareholder meeting—Standard General advanced a short slate of directors at the shareholder meeting of TEGNA (TEGNA's nominees were reelected). It is important to note that not all states allow virtual-only or hybrid shareholder meetings, and in the wake of the epidemic states rushed to amend their corporation laws to allow virtual-only meetings (e.g., in March 2020, New Jersey Business Corporation Act was so amended).
- **Regulation of proxy advisors.** As discussed above, proxy advisory firms Glass Lewis and ISS possess significant influence over shareholder proxy voting. In an effort to reign in their power, in August 2019, the SEC issued an interpretation and guidance directed at proxy advisory firms. The interpretation confirmed that the proxy advisors' vote recommendations are "solicitations" under the proxy rules and are subject to the anti-fraud provisions. The interpretation included some guidance on how investment advisors may fulfill their fiduciary duties while using the voting recommendations prepared by proxy advisors. In October 2019, ISS filed a lawsuit against the SEC challenging the interpretations and guidance. Subsequently, in November 2019, the SEC proposed amending the proxy rules in a manner that would, among other things, allow public companies (i.e., the incumbent directors and management) the opportunity to review and cause revisions to proxy recommendations before they are distributed to clients of proxy advisors. Proponents of the amendment said it would allow companies to correct errors in the reports of the proxy advisors, while opponents stressed that the proposed measure would hurt the independence of proxy recommendations. The proposal attracted numerous public comments, and in an effort to address those, the SEC started working on a compromise version of the measure (in particular, a "speedbump" approach was voiced out as a means to address "robo-voting"—during a short period of time after the distribution of a voting recommendation to clients, a proxy advisory firm would not be allowed to automatically vote on behalf of a client based on such recommendation).
- **Proxy plumbing initiatives.** In November of 2017, the chairman of the SEC expressed that the SEC may address the cumbersome proxy process for retail investors by revisiting the proxy plumbing concept. As a part of the proxy plumbing concept initially released in 2010, the SEC sought comments from the public on various issues relating to the efficiency and integrity of the proxy voting process, including over-voting and under-voting by broker dealers on behalf of their clients, vote confirmation mechanisms to let participants of the voting process verify whether and how their votes were cast, securities lending issues, empty voting issues, facilitation of direct communication between the companies and beneficial owners, strategies to increase retail investor participation in voting, and the role of proxy advisory firms. In September 2019, the SEC's Investor Advisory Committee adopted recommendations addressing some of the "proxy plumbing" issues. There is a consensus that further action on the part of the SEC and market participants is needed to upgrade the infrastructure supporting proxy voting.
- **CFIUS's role in hostile takeovers.** As mentioned above, on March 12, 2018, following the recommendation of CFIUS, the U.S. president issued an executive order blocking the $117 billion takeover bid of Qualcomm, a U.S. chipmaker, by Broadcom, a Singapore-based company, for reasons of national security. This was reportedly the first time that CFIUS caused a transaction to be enjoined in such a manner.

  The Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), signed into law on August 13, 2018, expands the jurisdiction of CFIUS to review four additional types of covered transactions:

  (1) Purchases, leases, or concessions by or to a foreign person of real estate located in proximity to sensitive government facilities.

(2) Other investments in certain U.S. businesses that afford a foreign person access to material nonpublic technical information in the possession of such business, membership on its board of directors, or other decision-making rights (other than through voting shares).

(3) Changes in a foreign investor's rights resulting in foreign control of a U.S. business or other investment in certain U.S. businesses. –and–

(4) Any transaction, transfer agreement, or arrangement designed to circumvent CFIUS jurisdiction.

On January 13, 2020, the U.S. Department of the Treasury, issued two sets of final regulations implementing the FIRRMA—one for certain covered real estate transactions and one for all other covered transactions.

Market Outlook

In the past years, activist investors emerged as influential figures in the market becoming more and more emboldened to initiate hostile competitions for control. As the activist investors mastered the playbook of the private equity groups, they became well positioned to take advantage of the new market conditions brought about by the coronavirus pandemic. Notwithstanding the operational, economic, and financial pressures created by the coronavirus pandemic, activist investors, corporate raiders, and private equity groups may continue driving the market for hostile transactions even during the period of this unprecedented uncertainty, which is expected to continue through 2020 and into 2021.

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For over 20 years, Mr. Glass has focused on complex M&A and securities transactions. Domestic and foreign companies and their boards seek his assistance with structuring and negotiating public and private mergers, acquisitions, divestitures, public securities offerings, proxy contests, and other highly complex corporate transactions. Mr. Glass also regularly counsels clients on continuous reporting and corporate governance requirements under the US securities laws and the rules of the NYSE and NASDAQ.

In 2018, he was named as a BTI "Client Service All-Star" based on the survey of general counsels of the Fortune 1000, an award that identifies attorneys that are "not just great—but head and shoulders above the rest as defined solely by clients." For several years running, Mr. Glass has been mentioned in Euromoney's IFLR1000 listing of the world's leading lawyers and recommended in The Legal 500 United States. He is a member of the Committee on Mergers, Acquisitions and Proxy Contests of the New York City Bar Association.

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