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Responding to Hostile Equity Takeover Bids

The exchange offer is often the weapon of choice in large hostile strategic take-over bids. In the U.S. it has usually taken the form of a merger proposal coupled with the threat of a proxy fight to remove the board of directors if the target does not accept. Outside the U.S. it takes the form of an exchange offer of the raider's shares for the target's shares. The Vodafone bid for Mannesmann is a cogent example. SEC rules now facilitate hostile exchange offers in the U.S. Major institutional investors generally support these hostile bids where there is a 25% or better premium over the target's market price prior to the bid. Targets have had little to no success in arguing that the raider's shares are overvalued or that the target's own shares should in the near future command a market price greater than the raider's bid.

In situations where both the raider and the target are comparable and the target's board believes that the target's prospects are better than the raider's, the target can take action to induce institutional investors to withhold support from the raider.

The target publishes the strategic plan that it believes will create additional value and commits to put itself up for auction if during a specified period (not more than two years) its stock does not sell in the market during a 30-day period at an average price (in appropriate cases indexed to the price of the raider's stock) greater than 125% (or other significant premium based on the particular circumstances) of the value of the raider's bid. To substantiate its commitment, the target agrees that if the auction is triggered it will appoint a committee of outside independent directors to manage the process and that that committee will consult with an advisory committee of the target's ten largest stockholders with respect to the process.

By committing to a significant premium over the raider's bid and agreeing to the auction process if the trigger price is not achieved, the target is saying to its stockholders, "your board of directors is convinced that it is a mistake to trade your target stock for raider stock — you will do better by holding your target stock." Therefore, stockholders who do not intend to sell the raider stock when they get it (or the target stock in the arbitrage market after the bid is announced) have a real incentive to reject the takeover bid. The agreement of the target to have the entire process managed by a committee of outside independent directors consulting with an advisory committee of the ten largest stockholders should satisfy the stockholders as to the bona fides of the target's commitment. This could be strengthened by the target's management tying its compensation to achieving the trigger price.

A variant of this approach (and the CVR concept) would be to consider the effect of the target issuing a CVR tied to the price of the raider's stock. If in a year or two the target's share price doesn't reach 120% of the raider's share price, the target would pay the difference to the CVR holders in cash (subject to a cap).

Since the target's action does not in any way prevent a stockholder from tendering to the raider, it cannot be said to be a poison pill and should not be deemed bid frustration.

In order for these types of responses to a hostile exchange offer to be effective, advance planning is necessary. The foregoing is just an outline of the basic structures. In many cases it will be important to act quickly to discourage institutions from selling into the arbitrage market. Also it will be very helpful to have analyzed in advance the likely raiders that fall into the category against which this strategy would be effective.

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