Federal Court Decision in Allergan Control Battle Raises "Serious Questions" for New Takeover Technique

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The Federal District Court's November 4th ruling in *Allergan, Inc. vs. Valeant Pharmaceuticals International, Inc.* raises "serious questions" for the takeover partnership employed by Valeant and Pershing Square in their hostile bid to acquire Allergan.

Pershing Square and Valeant joined forces in February 2014 to pursue a potential transaction with Allergan. The pairing of a strategic party with an activist hedge fund to make a hostile bid has been touted as a new takeover technique for today's M&A market. A troubling facet of the Pershing Square/Valeant alliance, however, involved Pershing Square building a stake in Allergan stock for several months before Valeant publicly announced a tender offer for Allergan in June 2014. The share accumulation technique was attacked by Allergan as a violation of the securities laws regulating tender offers and proxy disclosure.

The Court agreed, finding that Allergan had raised serious questions as to whether Pershing Square violated SEC rules against trading on material non-public information when it purchased Allergan stock in advance of Valeant's tender offer. The Court blocked Pershing Square and Valeant from voting any proxies solicited by them for the Allergan special stockholders meeting scheduled for December 18, 2014, until they make corrective disclosures regarding the claimed insider trading. The Court stopped short of enjoining Pershing Square from voting the 9.7% Allergan stake its fund allegedly acquired in violation of federal law.

Takeaways From This Decision

The decision highlights certain risks and vulnerabilities inherent in the type of takeover partnership employed by Valeant and Pershing Square and establishes several key principles for M&A practitioners advising in hostile takeover situations.

1. Activist Hedge Funds That Work Together With Hostile Bidders and Trade in Advance of a Tender Offer Are Exposed to Insider Trading Risk and Potential Stockholder Class Actions. Under the securities laws, once "substantial steps" toward a tender offer have been taken, a

party other than the "offering person" who possesses material nonpublic information relating to the tender offer must either abstain from trading or publicly disclose the information before trading. Substantial steps are measured by the actions taken by a bidder; not the bidder's stated intentions. The Court found that, despite Pershing Square and Valeant's written agreement stating that no steps had been taken toward a tender offer, Allergan had presented enough evidence to raise a serious question as to whether Valeant had taken such steps (e.g., hiring advisors, obtaining financing and agreeing with Pershing Square regarding their respective roles in a potential tender offer) between February and May at the time Pershing Square was buying up to 10% of Allergan's stock. The Court also indicated that Pershing Square may be subject to insider trading liability, including monetary damages to a class of Allergan stockholders who sold while Perishing Square acquired Allergan shares.

2. There is No Brightline Test for Determining Who is a Co-Offeror in a Tender Offer. The Court found that simply being a co-bidder for disclosure purposes or calling oneself a co-bidder did not exempt Pershing Square from the "disclose or abstain rule" because the purpose of the insider trading rules, including prohibiting bidders from "warehousing" the target's shares with friendly institutional investors, required a much narrower definition of offering person than was appropriate for disclosure purposes. Even though Pershing Square was active in both strategizing and financing Valeant's bid for Allergan from an early stage, it was still prohibited from trading because it had no control over the offer itself, including the price, or whether it would be called off.

3. Courts Remain Hesitant to Enjoin a Fully Informed Vote of Shareholders. The Court found that Valeant and Pershing Square's proxy solicitation disclosure for the December 18th special stockholders meeting was misleading because it did not disclose Valeant and Pershing Square's early plans to pursue a tender offer or that Valeant and Pershing Square's actions could subject them to potential liability for insider trading. The Court ordered Valeant and Pershing Square to make corrective disclosure prior to the shareholder vote. However, the Court did not enjoin Pershing Square from voting the allegedly wrongfully-acquired shares because the potential impact on a future takeover was too speculative (in the Court's words there were too many "ifs" between the purchase of shares and the ultimate takeover of Allergan) and anyone hurt by Pershing Square's purchases would be entitled to money damages later.

Implications for Market Practices

The decision is also likely to have key implications for M&A market practice.

1. Hedge Funds and Strategic Bidders Are Less Likely to View Partnership as an Attractive Takeover Tool. Given the investment horizon and strategies of most hedge funds, and activist funds in particular, it is unlikely that hedge funds will be willing to invest in a takeover

partnership in a way that will allow them to be considered an offering person for purposes of the "disclose or abstain" rule. Absent an ability to acquire a stake pre-announcement, hedge funds are unlikely to be willing to finance takeovers, and the risk of substantial monetary liability for insider trading will likely chill enthusiasm for partnering with a strategic buyer in the way Pershing Square did here.

2. The SEC Will Be Under Less Pressure to Weigh in on the Legality of the Technique. The chilling effect that the Court's decision may have on future strategic/hedge fund partnerships will relieve pressure on the SEC to provide general guidance regarding who is a co-offeror for trading purposes, or to determine in individual transactions whether the hedge fund is a co-offeror. The SEC will also likely permit the risk of private liability, rather than rulemaking, to deter future use of this partnership structure.

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