Client Alert

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Federal Court Grants Limited Relief in Pending Hostile Takeover Litigation

On November 4, 2014, a federal district court in California ruled in Valeant Pharmaceutical's pending $53 billion hostile takeover of Allergan, Inc. At issue was whether Valeant and activist hedge fund Pershing Square violated federal securities laws in coordinating Valeant's proposal. In ruling on Allergan's motion for a preliminary injunction, the court held that there were "serious questions" of whether Valeant and Pershing Square violated federal securities laws, including tender offer rules that prohibit trading on inside information. The court declined to enjoin Pershing Square's investment vehicle from voting its Allergan stock at Allergan's upcoming special meeting to unseat certain of its directors, but it did order the defendants to make certain supplemental disclosures about their pre-tender offer activities and their potential liability for federal securities law violations.

Court's Opinion

The litigation arose from Valeant's pending $53 billion takeover attempt of Allergan. Before Valeant publicly announced its offer, it met with Pershing Square to discuss its strategy. Valeant then entered into a cooperation agreement with Pershing Square. The parties then formed an investment vehicle, which had accumulated a 9.7% stake in Allergan by the time Valeant publicly announced its takeover proposal.

Allergan and one of its shareholders sued Valeant and Pershing Square in federal court, claiming that the pre-announcement purchases were illegal under the Securities and Exchange Commission's tender offer rules. They also claimed that Valeant and Pershing Square violated their disclosure obligations under the proxy rules.

Alleged Violation of Tender Offer Rules

The primary issue before the court was whether the investment vehicle's acquisition of Allergan stock constituted unlawful insider trading under the federal tender offer rules. Specifically, Rule 14e-3(d) prohibits an "offering person," defined as a person who "has taken a substantial step or steps to commence … a tender offer," from "communicat[ing] material, nonpublic information relating to [the] tender offer to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in a violation of" Rule 14e-3's prohibition on fraudulent, deceptive, or manipulative tactics.

The first issue is whether Valeant had taken substantial steps toward the tender offer such that the prohibition on insider trading was triggered. On the preliminary record, the court concluded that the plaintiff had raised "serious questions" as to whether Valeant had done so. Among other things, the court found that Valeant's board of directors met numerous times, Valeant hired legal and financial advisors, and Valeant knew the transaction would likely be hostile. The court also observed that the cooperation agreement between Valeant and Pershing Square contemplated that they would form a "Co-Bidder Entity" and each would be named as "co-bidders" if a tender offer was launched.

The next issue was whether Pershing Square was an "offering person" under Rule 14e-3. This status was relevant because the insider trading prohibition only applies to third parties, not the offering person.

Although Valeant clearly was an "offering person," the court concluded that the term "offering person" could encompass more than one person. The court also indicated that whether someone is an "offering person" depends, in large part, on the extent to which that person has control over the terms of the tender offer and over the surviving entity. The court explained that the purpose of Rule 14e-3 is to limit "the universe of persons permitted to trade on inside information only to the person making the tender offer." It also noted that, in adopting Rule 14e-3, the SEC was concerned about bidders leaking their proposed tender offer so that investors could trade at an informational advantage.

Based on the limited record before it, the court concluded that the plaintiffs had raised "serious questions as to whether Pershing Square is a co-offering person." Although Pershing Square helped in strategizing the bid and acquiring the toehold interest, the court focused on the fact that Pershing Square "had no control over the price to be offered to Allergan's shareholders, whether the tender offer would involve cash and/or an exchange of stock, or even whether to call off the tender offer at some point." It also noted that the tender offer documents explicitly stated that the tender offer was being made by a Valeant affiliate and that Pershing Square itself was not offering to acquire any shares.

Alleged Violation of Proxy Rules

The next issue was whether the plaintiffs had sufficiently articulated a violation of federal proxy rules promulgated under Section 14(a) of the Securities Exchange Act of 1934. The plaintiffs alleged that Valeant and Pershing Square should have disclosed that they agreed in a cooperation agreement to be listed as co-bidders in any tender offer and, in negotiating that agreement, they were cognizant of potential liability under Rule 14e-3. The plaintiff also alleged that they should have disclosed their potential liability under Rule 14-e3.

The court held that the agreement to be co-bidders and the defendants' potential liability for violating the tender offer rules would be important to a reasonable shareholder. It also noted that the widespread news coverage of the lawsuit did not alleviate the defendants' disclosure obligations.

Remedy

The court declined to enjoin the investment vehicle from voting its Allergan shares at the upcoming special meeting. It explained that, although serious questions as to legal compliance had been raised, the case involved novel legal issues and there was no definitive finding that Pershing Square or Valeant had violated federal securities laws. It also found that the alleged harm was too speculative to warrant injunctive relief.

The court did require Valeant and Pershing Square to make supplemental disclosures to Allergan stockholders. Specifically, the court held that they must disclose that their cooperation agreement provided that they would be listed as "co-bidders" in any tender offer, that the plaintiffs have alleged that the defendants have violated Rule 14e-3 by purchasing Allergan shares on inside information, and that the court found that the plaintiff "raised serious questions as to whether Defendants' conduct… violated Rule 14e-3."

Conclusion

Valeant's pending takeover attempt of Allergan has been groundbreaking in that Valeant teamed-up with a well-known activist hedge fund, which helped in acquiring a toehold and calling a special meeting of Allergan stockholders to remove its directors. The takeover attempt presented a novel strategy and has been viewed by many as an unusual alliance between a strategic bidder and an activist investor. The size of the hostile transaction is also notable, indicating that almost any public company can be a target.

The takeover also has raised interesting legal issues, and litigation remains pending in Delaware on various state law matters. The federal court's decision is far from a victory for Allergan. Namely, the court imposed limited relief in the form of supplemental disclosures, which the defendants can easily make. The Valeant/Pershing Square investment vehicle can thus vote its shares at the Allergan special meeting.

Allergan has announced it would file an emergency appeal seeking to overturn the federal court's ruling. It remains to be seen whether the specter of liability arising from the opinion will adversely affect the takeover attempt.

In the absence of definitive SEC interpretations on several key regulatory definitions, the court struggled at times to construe important elements of the tender offer rules. This case may serve as an impetus for the SEC or its staff to produce additional interpretive guidance on these issues. More fundamentally, the Valeant-Pershing Square alliance has been trailblazing in many key respects, and future bidders seeking to emulate the structure may refine their strategy and techniques in an effort to sidestep the many legal challenges that the Allergan hostile takeover has generated.

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