As Deal Market Heats Up, Old Tactics Are Reconsidered

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THE PLANETS are aligned once more -- the stock market is rising and the economy has risen from the dead -- propelling mergers and acquisitions into the headlines.

The deals look familiar: JP Morgan agreed to acquire Bank One in a friendly acquisition in January, continuing the merger trend in banking. Cingular Wireless successfully bid for its erstwhile competitor, AT&T Wireless, with $41 billion in cash. What is more, Comcast's hostile bid for Disney and Oracle's brash attempt to take over PeopleSoft remind boardroom voyeurs of the soap opera battles of RJR Nabisco in the 1980s.

But upon closer inspection, these mergers and acquisitions, friendly and otherwise, are operating in a different environment. Shareholders, particularly large institutional investors, have grown suspicious of headline-grabbing deals after enduring disappointing mega-mergers like AOL/Time Warner. The era of corporate governance has eviscerated once nearly omnipotent CEOs and their pliant boards. Although the tools available to M&A practitioners -- such as staggered boards and poison pills -- have stayed largely the same, their applications have changed dramatically in recent years.

Tools of the Trade

The world of M&A takeover tactics and defenses enjoy a colorful nomenclature redolent of the decade of corporate raiders from which many were born. Traditional defensive measures developed in the 1980s are popular today, with some new wrinkles on old strategies.

Staggered boards and poison pills remain the most popular defenses. When combined, said Professor Lynn Stout of University of California, Los Angeles School of Law, they make a "defense almost insurmountable." Sixty percent of the 2,000 companies tracked by the Investor Responsibility Research Center, a firm that provides research and consulting on corporate governance, included a staggered board; 55 percent implemented a poison pill provision.

Staggered elections are adopted so that all board members are not up for election on an annual basis, thus making it impossible to vote out the entire board in one election cycle. A poison pill can take a variety of forms, but one of the most commonly used allows existing shareholders to buy more shares at a discount price, thus making it very expensive for the acquirer, which cannot purchase at the discount price, to buy a majority holding.

In today's landscape, some widely used measures have backfired, however, serving as warnings to M&A practitioners. The Research Center cited a substantial increase in golden parachutes -- giant compensation packages executives of target companies receive upon a hostile takeover. MONY group, the target of a friendly takeover from French insurance giant AXA, voluntarily reduced severance payments to top executives triggered by the takeover. Its parachutes did little other than to aggravate opponents of the deal who claim that MONY has been undervalued, according to press reports.

Patrick McGurn of Institutional Shareholder Services, a proxy service provider and advocate of corporate governance, said that "[e]very friendly deal will face advanced scrutiny [and] they never used to." MONY has tried to reschedule a vote fearing that shareholders will turn down the deal. "It's a wake-up call to everyone," Mr. McGurn added.

MONY's troubles reflect today's skeptical environment. Shareholders in target and acquiring companies, regardless of whether they are involved in friendly mergers or hostile takeovers, have begun to flex their muscles, making it more difficult for company executives and boards to push through their plans.

Despite protests from institutional investors and corporate governance watchdogs, most lawyers still urge their clients to implement defensive measures. "I continue to believe that a staggered board is extremely useful for a board to have to resist an undervalued takeover," said Joseph Frumkin, an M&A partner at Sullivan & Cromwell.

Harvard Law School Professor Lucian Bebchuk agreed: "the key is a staggered board," he said, calling it a "formidable takeover defense."

But William Taylor of Davis Polk & Wardwell warned that "in this environment, a staggered board is virtually impossible unless you had a controlling shareholder."

Dennis Block of Cadwalader, Wickersham & Taft, one of the nation's leading M&A lawyers, confirmed that "in an era where shareholders have obtained an enormous amount of power ... it's very hard to convince shareholders" to install these defenses despite "empirical data" favoring implementation.

Studies confirm both attorneys' appraisal. Michael Klausner of Stanford Law School wrote in a white paper that in the 1990s, companies in an IPO stage regularly adopted staggered boards in their charters -- partly a byproduct of advice from M&A lawyers -- while shareholders increasingly opposed such measures for older companies that attempted to amend their charters to allow classified boards.

Sullivan's Mr. Frumkin also recommended that companies implement or retain a poison pill. Unlike staggered boards, poison pills do not require shareholder approval, according to Professor Stout, making them easier to implement.

Mr. Taylor of Davis Polk cautioned against a blanket approach to poison pills, however. He said that "for a lot of companies, they'd rather not put a pill in because it attracts attention," sending warning signals to Wall Street analysts and potential acquirers and upsetting corporate governance advocates. He and others recommended a "morning after pill," a measure a board can take after learning of a potential takeover.

The resurgence of corporate governance has also made it more difficult for companies to implement defensive measures. "The large institutional [investors] are more proactive about letting managers and directors know what they want," said Sullivan's Mr. Frumkin. With fears of corporate raiders fading from memory, he has seen a "changed landscape" where there is "less stigma to hostile takeovers."

Growing Disapproval

In many instances, investors have even removed staggered boards and poison pills. Pfizer, for instance, eliminated both its poison pill and staggered board last year in response to shareholder activists. "There has been a disarmament trend" among large-cap companies, said Mr. McGurn of Institutional Shareholder Services. Several studies of voting patterns show growing disapproval of defensive measures from shareholders. "The notion of doing anything that entrenches management," said Mr. Taylor, a partner in Davis Polk's corporate department, "is difficult at this time."

Even when defensive measures are in place, some experts think these weapons will be used with greater restraint. Institutional investors "are adding pressure and lobbying directors to be more amenable to takeovers," said Mr. Frumkin, making "it more likely for takeovers to succeed." He said that defensive tactics "are similar to what they always were but [they'll] be used less vigorously and less frequently." He said he sees a "significant change in people's mind-sets," where people are looking to "protect value" rather than employ a purely "defensive mindset."

"The bottom line is that this will be market driven rather than technique driven," said Mr. Taylor. "The market is going to be deciding what transactions make sense -- more now than the recent past," he added.

Cadwalader's Mr. Block agreed, stating that it will be "very hard for well-armed companies to say no" if a potential acquirer offers a fair price. Most takeovers start off as hostile deals, he said, and he recommended that companies work out their hostilities in "private, as deals should be done." Only negotiations that went awry or included an unreasonably low price end up as hostile takeovers when reaching the public, he explained, citing Oracle's fledgling bid for software rival PeopleSoft.

"There's nothing wrong with telling buyers that we need to sit down and negotiate a better price," advised Mr. Block. He expected more hostile takeovers as companies pursue acquisitions to continue to grow, making it all the more necessary to implement suitable defensive measures.

Today's publicity-filled campaigns present other, often unorthodox, problems for practitioners. How do Walt Disney Co.'s lawyers help deflect the growing public crusade to remove CEO and Chairman Michael Eisner, for instance? Roy Disney and others, utilizing a Web site called savedisney.com and extensive advertising, have effectively recruited institutional investors to oust Mr. Eisner.

Age-old techniques perfected by lawyers may do little to repel these maneuvers. Practitioners urge clients -- now more than ever -- to maintain effective lines of communication with shareholders, particularly large institutional investors and members of a founding family if there is one. With legal defenses under attack and underemployed, public relations plays a larger role for both corporations and their M&A lawyers.