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Allergan Fine Underscores Obligation to Disclose White Knight

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Editor's note: Gail Weinstein is Senior Counsel and Philip Richter is a Partner at Fried, Frank, Harris, Shriver & Jacobson LLP. This post is based on a Fried Frank publication by Ms. Weinstein, Mr. Richter, Scott B. Luftglass, Peter Simmons, and Warren S. de Wied.

Allergan Inc. has agreed with the SEC that it will admit to securities law violations and will pay a $15 million fine for disclosure violations in its Schedule 14D-9 relating to the unsolicited, public takeover bid for the company made by Valeant Pharmaceuticals International in 2014. According to the SEC, Valeant failed to disclose that, in response to the offer, Allergan engaged in negotiations for possible alternative M&A transactions. In the press release issued by the SEC on Jan. 17, 2017, the Director of the SEC's New York Regional Office stated: "Allergan failed to fully and timely disclose information about potential merger transactions it was negotiating behind the scenes in response to the Valeant bid."

The SEC action underscores the obligation under Schedule 14D-9 to disclose merger or acquisition negotiations (such as for a white knight transaction) following an unsolicited tender offer. The SEC Order provides some clarification of the SEC's view as to when discussions constitute "merger negotiations" that require disclosure.

Background

In June 2014, Allergan filed its Schedule 14D-9 in response to Valeant's bid, stating that the bid was inadequate and recommending that the shareholders not tender their shares into the offer. Allergan also stated in the Schedule 14D-9 that it was not engaged in negotiations relating to a merger or other extraordinary transaction in response to the tender offer. According to the SEC, Allergan then engaged in negotiations (i) with "Company A" about a possible acquisition of Company A by Allergan (which could have complicated the Valeant bid by making Allergan a much larger company), and (ii) with Actavis plc (which ultimately acquired Allergan) about a merger. Allergan never disclosed the Company A discussions, and disclosed the Actavis discussions only when the merger agreement was signed.

- **Required Schedule 14D-9 disclosure.** Item 7 of Schedule 14D-9 requires that a company disclose "negotiations" "in response to a tender [offer]" that relate to an "extraordinary transaction" (including a merger or acquisition). Rule 14D-9(c) expressly requires that a company amend its Schedule 14D-9 if any material change occurs.

- **Allergan's initial Schedule 14D-9 disclosure.** Allergan stated in its initial Schedule 14D-9 filing: "[Allergan] is not now undertaking or engaged in any negotiations in response to the [Tender] Offer that relate to or could result in" a merger or other extraordinary transaction. In addition, Allergan stated that, if it did enter into negotiations for a possible transaction, it would not disclose "the possible terms…or the parties thereto, unless and until an agreement in principle…has been reached" because the Allergan board had "determined that premature disclosure with respect to the possible terms of any transaction might jeopardize continuation of any discussions or negotiations."
- **Allergan's discussions with Company A.** According to the SEC, in August and September (after the Schedule 14D-9 was filed), Allergan engaged in negotiations with "Company A" for a possible acquisition of Company A by Allergan. The negotiations were terminated by Company A after it conducted due diligence. The SEC stated in its Order that an obligation to update Allergan's Schedule 14D-9 to indicate that "negotiations were underway and were in the preliminary stages" was triggered when Allergan received a "counterproposal [from Company A] on [the] price" that Allergan had proposed.
- **Allergan's discussions with Actavis**. According to the SEC, on October 4, the CEO of Actavis proposed to the CEO of Allergan that Actavis would pay $185-200 per share to acquire Allergan. On October 6, Allergan insisted that the price had to be higher than $200. Actavis made a series of increasing price proposals through October. On November 3, Allergan disclosed that it had been approached by "another party" about a possible transaction (without any other information). On November 5, Allergan and Actavis entered into a confidentiality and standstill agreement and Allergan permitted Actavis to conduct due diligence, on the understanding that Actavis was proposing $210-215 per share and that Allergan wanted more than $215. On November 6, Allergan disclosed that it was "in discussions" concerning a possible merger that "may lead to negotiations." There was no additional disclosure until the November 17 announcement that Allergan and Actavis had signed a merger agreement (at $219 per share). The SEC stated in its Order that an obligation to amend the Schedule 14D-9 to disclose that "negotiations had begun, even though they were in the preliminary stages" was triggered when Allergan "indicat[ed] a specific price level to Actavis on October 6."
- **SEC staff's repeated requests for disclosure of discussions with Actavis.** As the SEC noted in its Order, beginning September 23, following press reports that Allergan was in discussions with potential white knights, the staff of the SEC's Division of Corporate Finance repeatedly warned Allergan that "to the extent that [Allergan] was engaged in merger negotiations, Schedule 14D-9 required those negotiations to be disclosed."

Key Points

- **The disclosure obligation applied to Allergan due to the applicability of Schedule 14D-9.** Importantly, the disclosure issues arose because Allergan, being the subject of a tender offer, was subject to the Schedule 14D-9 rules, which require disclosure of merger negotiations undertaken in response to a tender offer. In the context of a bid that is *not* a tender offer, target companies engaged in negotiations with respect to a possible transaction generally have no affirmative obligation to disclose the negotiations unless (i) the company has made inconsistent statements that must be corrected (*g.*, affirmative

statements that the company is *not* engaged in discussions about a merger); or (ii) leaks about the pending transaction have occurred and are attributable to the target company.

- **Practical considerations relating to white knight negotiations and disclosure.** Generally, for a variety of reasons, target companies and white knight suitors prefer *not* to have preliminary negotiations disclosed. The suitor typically will want to avoid being associated with a potential deal until it has decided to commit to it and will also want to avoid attracting competition for its potential transaction. The target company typically will not want to be put "into play" before a final decision has been made about selling the company; will not want to lose a potential white knight's interest due to premature disclosure; and will not want to unsettle employees and other constituents of the company prior to having a deal.

Notable factors relating to the Allergan situation:

- **SEC disclosure warnings**. As discussed, the SEC stated in its Order that Allergan had failed to make timely disclosure "despite repeated requests" from the SEC staff that it make "appropriate disclosures." Allergan had disagreed with the view that disclosure was necessary, taking the position that the discussions were too preliminary to constitute "negotiations." In response to the staff's repeated requests, Allergan ultimately amended its Schedule 14D-9 (on November 6) to add: "We have been approached by another party regarding a potential merger transaction. Discussions between us and that party have continued and may lead to negotiations." After this additional disclosure, the SEC continued to warn Allergan that disclosure that negotiations were underway at a preliminary stage might be required and that Allergan should make "appropriate disclosures."
- **Pricing discussions.** The SEC pointed to the specific price indications given by the target company (in the discussions with both Company A and Actavis) as the triggering event for a disclosure obligation under Schedule 14D-9 that preliminary negotiations were underway. Moreover, we note, well in advance of execution of the merger agreement with Actavis, there was extensive back-and-forth between Allergan and Actavis on price, within a relatively narrow range—which clearly could be viewed as suggesting that significant negotiations had been underway.
- **Lengthy process, with unusual level of shareholder engagement.** We note that the lengthy duration of Allergan's process, extending over many months, made leaks and rumors about the process more likely. Further, the extensive engagement with shareholders—by both Allergan, on the one hand, and Valeant and its shareholder activist co-bidder, on the other hand—-in connection with proxy contests on various issues relating to Valeant's bid, increased the visibility of the process to the shareholders, the market, and the SEC.

Practice Points

"No comment" policy in non-tender offer situations. Most companies have adopted a policy pursuant to which they consistently respond with a "no comment" statement to all inquiries relating to merger negotiations. If, instead of a consistent no comment policy, a company's response to inquiries about whether it is engaged in negotiations alternates between "no comment" (when the company *is* in negotiations) and "we are not in negotiations (when it is *not* in

negotiations), the responses are likely to signal to the market when the company is or is not in negotiations.

What constitutes "negotiations" that trigger a Schedule 14D-9 disclosure obligation. The SEC has characterized "negotiations" for Schedule 14D-9 purposes as consisting of "any substantive discussions" between the target company and a potential white knight about a possible transaction (*Lionel*). As discussed, with respect to Allergan, the SEC pointed to target company statements on pricing as triggering the disclosure obligation. We note that the determination will be based on the all of the facts and circumstances in a given situation. Generally, at one end of the spectrum, inquiring of a potential bidder whether it might have interest in a transaction with the target company should not be deemed to be a disclosable "negotiation." At the other end of the spectrum, discussions that have led to what is in effect an agreement in principle (albeit un-executed) would have to be disclosed. If negotiations are in progress and disclosure may be required, the SEC rules permit disclosure that preliminary negotiations are underway, without identifying the parties or terms, if the board determines that disclosure might jeopardize further negotiations. That disclaimer will not, however, obviate the need to disclose the fact that merger negotiations are underway once they are underway.

Situations involving 14D-9 disclosure violations. Examples of situations in which Schedule 14D-9 disclosure violations have been found relating to negotiations in response to a tender offer include the following: As in the Allergan situation, a company stated that it was not in merger negotiations and later commenced negotiations without updating the disclosure (*Allied Stores*). A company stated that it "may undertake negotiations" although it had already commenced negotiations (*Revlon*).