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Recent SEC Enforcement Proceeding Highlights Disclosure Obligations of Publicly Traded Companies Exploring Alternatives to Unsolicited Offers – Those Explorations Can't Always be Kept Secret

On January 17, 2017, the SEC issued an Order providing for a consent decree in a proceeding it initiated against Allergan, Inc. In the proceeding, the SEC alleged (and Allergan admitted) that Allergan failed to make timely disclosures in 2014 of Allergan's attempts to negotiate business combination transactions that could serve as alternatives to the hostile takeover proposal made to Allergan by Valeant, first publicly announced in early 2014. Those alternatives, explored by Allergan after Valeant launched a tender offer for Allergan's shares in June 2014, included a possible acquisition by Allergan that if consummated would make Valeant's hostile bid more difficult to complete, and a possible "white knight" transaction in which Allergan would combine with Actavis. The potential acquisition by Allergan ultimately was not completed; the combination with Actavis *was* completed. The Order imposes a cease and desist order and a penalty of $15 million. It can be found here.

The Order provides an important reminder of the various exceptions to the general rule that, under U.S. law, public companies are not required to disclose discussions or negotiations regarding business combination transactions until a definitive agreement for a transaction is entered into. The Order also raises some interesting policy considerations, because arguably the disclosure the SEC found should have been made would not have helped market participants trading Allergan's stock and could have impaired the efforts by Allergan's board to maximize shareholder value.

The general practice in the U.S. is that a publicly traded company that is exploring or negotiating a business combination transaction (including a transaction involving the sale of the company) will not publicly disclose the transaction until a definitive agreement for a transaction has been entered into. The 1988 decision of the U.S. Supreme Court in *Basic v. Levinson* endorses this approach. The *Basic* decision does *not*, however, hold that earlier disclosure is *never* required. Instead, the decision makes clear that earlier disclosure *will* be required of a company engaged in merger discussions:

1. under a material omission theory, to supplement statements made by or on behalf of the company, in order to render those statements not misleading (a commonly cited example in the M&A world occurs when a company denies takeover rumors, either directly or by saying something indirect like it knows of no reason why there has been unusual activity in its stock);
2. to avoid making a material misstatement or omission in connection with a purchase or sale of its securities (private or open market share repurchases in particular can violate Rule 10b-5); and
3. if required under line item disclosure requirements imposed under the SEC's rules.

Allergan's situation fell into this last category, but with a twist. The disclosure obligation arose because when Valeant launched its hostile tender offer, Allergan was required under the SEC's tender offer rules to respond by making a filing with the SEC on

Schedule 14D-9 and disseminating the information in that filing to its shareholders. Item 7 of Schedule 14D-9 requires the target of a tender offer to disclose if it enters into "negotiations" "in response to the tender offer" that relate to an "extraordinary transaction," including a merger or acquisition by a third party. Pursuant to that requirement Allergan made the following disclosure in its initial Schedule 14D-9 filing:

> Allergan is not now undertaking or engaged in any negotiations in response to the Offer that relate to or could result in one or more of the following or a combination thereof... (2) any extraordinary transaction, such as a merger, reorganization or liquidation, involving Allergan or any of its subsidiaries….

There is no suggestion in the Order that this statement was not true when made. Instead, the Order focuses on the requirement imposed on Allergan under Rule 14d-9(c), to promptly amend its Schedule 14D-9 to disclose any material change in the information previously provided. According to the Order, at the point at which Allergan began exchanging price proposals and counterproposals on the two alternative transactions it considered, it was "engaged in… negotiations." At that time, according to the Order, Allergan was required to "promptly" amend but failed to do so.

The Order describes the widespread rumors in the marketplace regarding Allergan's discussions with Actavis, and the SEC staff's attempts, after learning of those rumors, to press Allergan and its counsel to make "appropriate disclosures." Pursuant to these discussions Allergan supplemented its disclosures to disclose first that it had been approached by another party regarding a potential transaction, and subsequently that discussions with the other party had continued and "may lead to negotiations." The Order describes the SEC's view that this disclosure was inadequate because it failed to state that Allergan was already in "negotiations" (because it had exchanged price proposals). This portion of the Order suggests that perhaps the resistance displayed by Allergan and its counsel in response to the staff's requests, and the prevalence of market rumors, may have been significant factors in the SEC's decision to bring an enforcement proceeding.

Perhaps so, but from a policy perspective Allergan and its counsel nonetheless may have been on the right side of the issue. As a purely technical matter, it is not unreasonable to apply the "material change" requirement of Rule 14d-9(c) by analyzing whether the change in information would be material to an Allergan shareholder's decision to tender the holder's shares at the time of the analysis. In the fall of 2014 (the time the SEC found Allergan should have updated its disclosures but did not), it was not yet possible for Valeant to close its tender offer because it hadn't yet dismantled Allergan's takeover defenses. Accordingly, it may have been reasonable for Allergan to conclude that vague, preliminary information regarding discussions that might or might not lead to a transaction would not be material because it would not help an Allergan shareholder decide how to respond to Valeant's tender offer – because it wasn't yet time to respond. Certainly it does not necessarily seem unreasonable to conclude in those circumstances that disclosing the fact of "discussions" rather than "negotiations" might be acceptable and even preferable, because that usage emphasizes the uncertainty that presumably remained regarding the ultimate outcome, and wouldn't be likely to harm Allergan's shareholders. That conclusion would allow a result in line with the policy consideration underlying the Supreme Court's *Basic* decision – that the potential for premature disclosure to derail takeover discussions or limit a company's negotiating leverage should outweigh the benefits of the otherwise-preferable approach of regularly updating the information relied on by persons trading in the company's securities.

Here, a disclosure that discussions or negotiations were taking place arguably would not meaningfully have helped an Allergan shareholder but it might have deterred other potential bidders, and it also might have strengthened the negotiating positions of the parties with whom Allergan was negotiating, by providing those parties with real-time updates as to the competition they faced. An Allergan board seeking in good faith to maximize shareholder value might fairly have concluded that the approach it took to disclosure was preferable.

Take aways:

- The analysis endorsed in the Order is unique to a situation in which a company faces a hostile tender offer – it doesn't otherwise displace the general principle that in most cases, merger negotiations need not be disclosed until a definitive agreement for a transaction is entered into.
- A company faced with a hostile offer should realize the SEC is likely to press for early disclosure regarding the status of possible alternative transactions – especially if leaks regarding an alternative transaction occur. A company in that situation should pay particular attention to the position apparently taken by the SEC that the exchange of price proposals and counter-proposals triggers a bright line test for the commencement of "negotiations."
- Hostile bidders should appreciate the SEC's position gives them a reason to commence a tender offer early, because they may now have a greater ability to squeeze disclosure from the target regarding the target's defensive tactics.

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