

M&A Interactive

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MYLAN EMERGES VICTORIOUS!

Of Strategies, Lifesavers and Poison Pills

The heightened M&A deal activity in the pharmaceutical sector globally has the industry in frenzy. A recent study shows that the announced M&As targeting the pharmaceutical sector had already crossed USD 59.3 billion by March, 2015, accounting for 10.5% of the overall M&A activity by value¹. In the fight to stay relevant, pharma companies that are encountering challenges of limited IP protection, new and rapid developments, prolonged FDA approvals, the need to diversify product portfolios and the like, perhaps have no choice but to seek inorganic growth strategies. Questions are being raised as to whether M&A activity is actually replacing R&D in this sector with economies of scale and reduced R&D costs being the fundamental drivers².

THE MACRO-ECONOMIC LANDSCAPE

Globally, the aggression in pursuing M&A deals in the pharmaceutical sector is quite apparent. Indian companies have been seen to pursue inorganic growth aggressively - Lupin's proposed acquisition of Gavis Pharmaceutical and Novel Laboratories and Sun Pharma's acquisition of Ranbaxy Laboratories, are cases in point. While mega mergers involving India have been largely docile, the international story isn't quite the same. Last year, various hostile takeover attempts made headlines such as Pfizer's \$118 billion bid to acquire AstraZeneca and Valeant Pharmaceuticals' victory in acquiring Salix Pharmaceuticals for \$11.1 billion after outbidding its leading rival bidder Endo International. Some deals were also led by activists such as the merger between Forest Laboratories and Actavis Plc. for USD 25 billion and Actavis Plc.'s acquisition of Allergan Inc. after a long drawn hostile battle with activist investor Bill Ackman and Valeant Pharmaceuticals International Inc.

HOSTILITY PAVES THE WAY?

One may inquire as to what is driving hostile acquisitions in the pharmaceutical sector? Is it that good assets belong to reluctant sellers who have bets on the economy going forward? Or is it that luring shareholders with premium amounts is a simpler task that convincing a board which may be driven by other factors apart from the price?

TEVA-MYLAN-PERRIGO CONTROVERSY

This year, of the recent hostile takeover battles, the one that had the market abuzz with its multi-front drama is the Teva-Mylan-Perrigo saga. The three-way takeover war started when Mylan N.V. ("Mylan") launched an unsolicited bid to takeover Perrigo Company Plc. ("Perrigo") on April 06, 2015 at a premium of more than 25% for an overall consideration of over USD 29 billion cash-and-stock deal³. Not long after, Robert J. Coury, Executive Chairman, Mylan received a 'bear hug'⁴ for a compelling USD 43 billion (on a 50:50 cash-stock split basis) from Teva Pharmaceutical Industries ("Teva") for a whopping premium of 48.3%⁵. A Bloomberg report suggests Teva's interest in acquiring Mylan stemmed from Teva's attempt to counter-balance the loss of market share to Indian manufacturers such as Sun Pharmaceutical Industries Ltd. and to combat competition from generic manufacturers⁶. Given Mylan's strong focus on prescription generics, the Perrigo acquisition for Mylan should provide an exposure to the over the counter segment of generic drugs or so it has been portrayed. The deal economics aside, what caught the attention of the market are the intricate defense strategies adopted by the Mylan board to fend off the hostile bid by Teva which eventually seemed to have worked in Mylan's favour as Teva finally withdrew its hostile bid⁷ and decided to pursue Allergan instead. We evaluate these defenses in this M&A interactive, both in terms of their strategic value and their viability under Indian law.

THE DEFENSE STRATEGY

The use of the 'poison pill'

What better way to fend off a hostile takeover than to explore the use of the all-time favourite 'poison pill defense'. Recall Mylan's acquisition of the generics business from Abbott Laboratories in a controversial inversion deal as a part of which Mylan shifted its headquarter from Pittsburgh to the Netherlands. Unbeknownst to all, this shift and the contours of the Dutch law enabled Mylan to use a variation of the poison pill that proved to be onerous for Teva. At the time of the Abbott acquisition, Mylan's shareholders had approved a version of poison pill which was embedded in Mylan's articles of association i.e. the 'Dutch Foundation Defense' on the basis of which Mylan 'stichted' an option agreement with a Dutch foundation, an independent entity established to promote and safeguard the interests of Mylan and its stakeholders including from influences that might adversely affect or threaten Mylan in the future. The option agreement granted the Dutch foundation a revolving option to purchase preference shares up to a maximum number equal to the total number of Mylan ordinary shares for a nominal value and consequently diluting the acquirer's stake. Upon the exercise, the Dutch foundation could hold up to 50% of economic and voting share capital of Mylan for a nominal sum. The intention is for the option to be exercised independently in furtherance of the objective of the Dutch Foundation in situations where the Dutch foundation felt that the interests of Mylan needed to be protected.

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Scorched earth defense

While there are stakeholders (including Apollo, a 14.5% shareholder in Mylan who is said to vote in favour of the Perrigo transaction)⁸ that believe that the Perrigo acquisition will have commercial benefits for Mylan, it has also been asserted that apart from the poison pill defense, Mylan was pursuing the Perrigo acquisition as a 'scorched-earth defense' to make itself unattractive for Teva. Given that Teva's bid was contingent on the Perrigo acquisition not being pursued the above assertion may have some merit.

Regulatory defense

Mylan's cries as regards to the anti-competitive effect of the Mylan-Teva merger were further boosted by a group of consumer activists who had called upon the United States antitrust regulator to 'thoroughly investigate the 'Teva-Mylan merger' and 'to block it' citing various anti-competitive effects that it would have on consumers and on the competition within the industry⁹. Going one step further, the activists were emphatic that the customary curable measure that the antitrust authority would normally resort to in a merger of likes such as divestiture of overlapping products would not remedy the *loss of competition* that would come about as a result of the Teva – Mylan merger. However, given the wide hell or high water clauses that the Teva had offered, it would have been interesting to see how the antitrust authorities would have manoeuvred such an approval.

WOULD THE MYLAN DEFENSE STRATEGIES WORK IN INDIA?

Historically, Indian companies had a self-built defense strategy that withstood hostile takeovers i.e. concentrated promoter shareholding. Given the current macro economic climate where (i) there is a more broad based market participation; (ii) consistent decrease in promoter shareholding over the years; (iii) more professionally managed companies; and (iv) more active and informed shareholder participation, the traditional protections may not be available to Indian companies. In 2012, the Economic Times suggested that India Inc. had 480 companies that were vulnerable to hostile takeover risk with promoter shareholding below 25%¹⁰.

Whilst it appears that some Indian companies may be vulnerable to hostile takeovers, the defenses available may be inadequate. Let's explore the Mylan defenses to see how this would play out in India.

The poison pill defense

For the poison pill defense used by Mylan to be effective, the following elements were key: (i) free pricing and timing of issuance; and (ii) disproportionate value to the holder as against the acquirer. Where a listed company is concerned, the board is constrained from issuing shares to a specified shareholder to the exclusion of others without a supermajority consent of the existing shareholders. Other regulatory prescriptions limit the manner, the price and the timelines within which such securities shall be issued. Therefore, the traditional poison pill defense that automatically gets triggered and dilutes the existing shareholder interests and thereby precludes a potential acquirer may not be available in India.

Scorched earth defense

When it comes to the scorched earth defenses, while there may not be such strict regulatory prescriptions in pursuing an acquisition to fend off a hostile bid prior to a hostile acquisition being announced, the Takeover Code, if very strictly read could put a dampener in this strategy. Regulation 26 of the Takeover Code does not strictly forbid a target company from pursuing an acquisition but it does preclude the target board from entering into a 'material contract' without super majority shareholder consent during the offer period which may be construed as restriction on acquisitions similar to the one pursued by Mylan. It may be worthwhile to note that Regulation 26 is an 'acquirer friendly' provision which prohibits the board from engaging in scorched earth defenses which involve increasing borrowings or alienating assets without super majority shareholder consent.

Regulatory protections

When it comes to seeking the protections to the regulators, in India, the Indian antitrust authority, CCI, has been active in soliciting comments from various stakeholders in mega mergers – for example the approval of the CCI in the Sun Pharmaceuticals Industries Limited – Ranbaxy Laboratories merger was contingent on divestiture of several overlapping products. Although, the CCI has not sought to block an acquisition or a merger till date, it is well with its powers to do so if it results in an appreciable adverse effect on the competition in India. In India, at least where the pharma sector is concerned, we have other regulators that could come to the aid of the defense of the Indian company in situations where the acquirer is a non-resident namely, the FIPB since any acquisition of shares in an existing Indian pharmaceutical company requires the approval of the FIPB. This strategy was effectively used by Asian Paints to ward off the takeover that ICI had planned of Asian Paints, albeit at a time when the laws in India in regards to foreign investment were very different.

WHAT ELSE CAN BE DONE IN THE INDIAN CONTEXT?

White knight

The other defenses that have been successfully deployed in the Indian context is the 'white knight defense' wherein the existing management partners with a friendly investor / strategic player to maintain control of the target company. The 'white knight defense' was employed in 2001, by BAT-controlled VST Industries where ITC entered as a white knight for BAT to thwart the takeover bid made by Mr. R.K. Damani. Similarly in 2010, Reliance Industries played white knight to the promoters of EIH by buying its 14.1% shares in order to thrash ITC group's attempt to make an open offer after it had raised its stake in EIH to 14.8%. Among the more recent deals, Kalindee Rail Nirman employed a seemingly white knight approach when **Saroj Poddar's Texmaco Rail** invested in the company fending off Jupiter Metal as it explored a hostile bid. Recently, Saroj Poddar also played the white knight to Mangalore Chemicals against hostile acquirer Deepak Fertilizers.

Embedded defenses

There other embedded defenses that may be available in India, however, the same has not been successfully tested in Indian courts. These include (i) guaranteeing rights of the promoters in the charter documents of the target company such as their ability to appoint majority of the non-independent directors; or (ii) inserting anti-takeover clauses in material contracts which stipulate that upon a 'change of control' the contract will be terminated.

Several Indian promoters have housed their brand and other valuable assets used by the principal target company in a separate private company, wholly controlled and owned by the promoters such that, in the event of a hostile takeover, acquisition of the principal target company would result in the acquirer not having access to the whole suite of assets that the target company requires for its business. The SEBI laws only prescribe the manner in which related party transactions need to be carried out but do not, as such, restrict the type of related party transactions that a target company can engage in. Further, the automatic termination of such arrangements may not even be caught within the restrictions imposed by Regulation 26 of the Takeover Code.

Last year, the Financial Times reported that hostile takeovers are making up the greatest proportion of global deal activity in over 14 years¹¹. The dynamic and booming M&A landscape in India, shifting legal and regulatory paradigm and rise in shareholder activism over the years creates a fertile ground for hostile takeover activity in India. Therefore, this global trend may soon start percolating down to India and therefore, it is imperative for the Indian corporates to prepare, anticipate and innovate strategies to take on such takeover overtures.

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You can direct your queries or comments to the authors

¹ See 'Pharmaceutical M&A Activity', Source: Thomas Reuters, V. Flasseur, March 05, 2015, available on http://pdf.reuters.com/pdfnews/pdfnews.asp?i=43059c3bf0e37541&u=2015_03_05_12_45_681be275ac9e4631837c0231e2014223_PRIMARY.jpg, last visited on July 28, 2015

² See 'M&A in the Pharmaceutical Sector', December 2014, available at http://www.financierworldwide.com/ma-in-the-pharmaceutical-sector/#.Va_a6LPzrlV, last visited on July 28, 2015 and 'Are M&A Replacing R&D In Pharma?' By Nicole Fisher and Scott Liebman, April 22, 2015, available at <http://www.forbes.com/sites/nicolefisher/2015/04/22/are-ma-replacing-rd-in-pharma/>, last visited on July 28, 2015

³ See Press Release by Mylan dated April 08, 2015, available at http://www.mylan.com/en/news/press_releases/item?id=123296

⁴ Bear hug is generally adopted by the acquirer to pressurize management or shareholders of the Target to consent to the acquisition. It involves informing the management about the intent to acquire through a proposal without any prior warning.

⁵ Mylan's unaffected share price USD 55.31 per share as on March 10, 2015 i.e. last day of trading prior to the wide-spread speculation of a transaction between Teva and Mylan.

⁶ See 'Teva Makes \$40 Billion Unsolicited Takeover Bid for Mylan', by David Wainer, available at <http://www.bloomberg.com/news/articles/2015-04-21/teva-makes-40-1-billion-unsolicited-takeover-offer-for-mylan>, last visited on July 28, 2015.

⁷ See 'Teva Withdraws Proposal to Acquire Mylan' available at <http://ir.tevapharm.com/phoenix.zhtml?c=73925&p=irol-newsArticle&ID=2071089>, last visited on July 28, 2015.

⁸ See 'Mylan Issues Statement in Response to Abbott's Support for Perrigo Transaction', June 16, 2015, available at <http://apps.shareholder.com/sec/viewerContent.aspx?companyid=ABEA%AD2LQZGT&docid=10763319>, last visited on July 28, 2015.

⁹ See 'Coalition presses federal officials to block hostile takeover of Mylan', July 14, 2015, available at <http://www.post-gazette.com/business/healthcare-business/2015/07/14/Coalition-urges-Federal-trade-commission-to-block-Teva-s-hostile-takeover-of-Mylan-pittsburgh/stories/201507140177>, last visited on July 28, 2015.

¹⁰ See '480 cos vulnerable to hostile takeover risk with promoter shareholding below 25%', April 03, 2012', available at http://articles.economictimes.indiatimes.com/2012-04-03/news/31281493_1_hostile-takeover-promoter-holdings-new-takeover, last visited on July 28, 2015.

¹¹ See 'Hostile takeovers rise to 14-year high in M&A as confidence grows', By Arash Massoudi in London and Ed Hammond in New York, June 08, 2014, available at <http://www.ft.com/intl/cms/s/0/a8a8f608-eee5-11e3-8e8200144feabdc0.html#axzz3h4T3JUJQ>, last visited on July 28, 2015.

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