

## IT'S A HOSTILE WORLD:

Responding to Unsolicited Take-Over  
Proposals

Practicing Law Institute  
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### HOSTILE DEAL ROLE PLAY

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## DEAL ANNOUNCEMENT

- Acquirer – BioTron Inc.
  - Mid-sized research pharmaceutical company
  - Market Cap: \$7.5 billion
  - Publicly Traded on NYSE
  - Share Price: \$50
- Target – MicroPharm Inc.
  - Small infectious disease pharmaceutical development company
  - Market Cap: \$900 million
  - Publicly Traded on NYSE
  - Share Price: \$14
  - Delaware Corporation

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## Material Deal Terms

- Part Cash / Part Stock Merger Transaction with Contingent Cash Payment Rights
  - Premium
    - 10% for MicroPharm shareholders; stock continues to trade near its 52-week low despite recent market improvement
  - Contingent Cash Payment Rights
    - MicroPharm shareholders will also be granted contingent cash payment rights
    - Pursuant thereto, MicroPharm shareholders will receive up to an additional \$3 per share to the extent that MicroPharm, during the three year period following the consummation of the transaction, achieves certain net sales targets
  - Lock-up
    - CEO of MicroPharm has agreed to roll-over and vote his 13% stake; no other controlling shareholder
    - 4.5% Break-up Fee (approximately \$44.5 million)

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## Material Deal Terms

- **Management Incentives**
  - Golden Parachutes – 6% of total consideration
  - Various lucrative, long-term Employment Agreements to existing MicroPharm senior management
- **Other Terms/Information**
  - Merger Agreement includes a No-Shop provision
  - Fiduciary Out – however, transaction must be brought to a vote of the shareholders of MicroPharm
  - Reverse break-up fee of 7% (approximately \$69 million)
    - Reverse break-up fee payable only if BioTron terminates the transaction due to the inability to obtain regulatory approval or if MicroPharm's newest product (ViralStop) is rejected by the FDA
  - MicroPharm has \$150M in debt coming due at the end of July 2010 which it may be unable to refinance at attractive rates given current market conditions

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## SCENE #1

### HedgeHog Complains

**HedgeHog**, an aggressive activist hedge fund owning a 4.5% interest in MicroPharm, discusses deal announcement with its Counsel, Mr. Corporate Partner

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## HEDGEHOG CONVERSATION

- **HH Manager** –
  - Argues that MicroPharm is on the verge of a turn-around and expresses opposition to the transaction; states that lots of other hedge fund shareholders feel that this is a bad deal for them and a sweet deal for management (large hedge fund shareholders own approximately 25% of the stock)
  - States that his colleagues at other large funds could easily control the vote of 51% of the outstanding stock in MicroPharm and scuttle the deal
  - States that he has a good relationship with the CEO of EuroDrug (a large, European drug and surgical equipment company) who may be interested in acquiring MicroPharm at a higher price
- **CP** – Explains:
  - Should he and his hedge fund colleagues act in concert in acquiring greater than 5% of the stock they would each need to disclose their actions on a Schedule 13D
  - Generally it is difficult to defeat a friendly transaction; DE law requires approval of a majority of the shares outstanding
  - With the CEO lock-up in place, 13% of the outstanding shares are already committed to vote for the deal. Furthermore, the proxy statement states that other insiders control another 9% of the outstanding shares of MicroPharm, a large portion of which will likely vote in favor of the transaction

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## HEDGEHOG CONVERSATION

- **CP** – Suggests three potential options:
  - Approach EuroDrug about pursuing a competing bid
    - HedgeHog has no obligation to disclose talks (not a 13D filer)
    - If EuroDrug makes competing offer, HedgeHog’s meddling might become public
  - HedgeHog does need to be concerned that BioTron will file a tortious interference suit against it
- Disinterested Person Solicitation
  - Can communicate with other shareholders (including “fight” letters) but cannot include own proxy card
- Contested Solicitation (Proxy Fight)
  - Expensive ~ \$1 Million

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## SCENE #2

Hello Mr. Interloper

**EuroDrug Inc.**, a large international drug and surgical equipment manufacturer with shares traded on the NYSE, discusses the possibility of making a competing bid with its counsel, Mr. Big-Time Attorney

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## EURODRUG CONTEMPLATES

- **EURODRUG CEO** – Explains that he was approached by a shareholder regarding getting involved in the bidding for MicroPharm; explains that MicroPharm is an attractive company and could be a good fit for EuroDrug and that the acquisition by BioTron could put it at a competitive advantage; asks what options exist?
- **BTA** – First step is to examine the defensive profile of EuroDrug to determine what other alternatives exist:
  - Classified Board – No
  - Removal of Directors – Yes
  - Fair Price Provision – No
  - Shareholders Calling Special Meetings – Yes
  - Shareholder Action by Written Consent – Yes
  - Advance Notice for Shareholder Proposals/Board Nominations – No
  - Golden Parachutes – Yes
  - Blank Checked Preferred – No
  - Poison Pill in Effect – No

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## EURODRUG CONTEMPLATES

- **BTA**
  - As MicroPharm does not have a Staggered Board and allows shareholders to Act by Written Consent one potential avenue is an Unsolicited Tender Offer coupled with a Consent Solicitation in order to remove the current Board and replace with a more friendly Board
  - Explains that if EuroDrug does make a bid, BioTron may raise its offer and an auction situation could occur
  - Further explains that there is not currently a "poison pill" in place, but MicroPharm's Board could insert one to delay EuroDrug's offer
  - Also, the Break-up Fee in the BioTron deal places EuroDrug at a bidding disadvantage
  - Additionally, EuroDrug could issue a publicly disclosed "Bear Hug" letter
- **EURODRUG CEO**
  - Asks whether EuroDrug could challenge the Break-up Fee
- **BTA**
  - Generally break-up fees are upheld, but a 4.5% break-up fee is a bit on the high side and could be overturned by a court

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## EURODRUG CONTEMPLATES

- **EURODRUG CEO**
  - What are the next steps?
- **BTA**
  - Speak with I-Banker (including to assist in valuation analysis)
  - Review publicly available information
  - Consider public "Bear Hug" letter
  - Prepare tender offer and consent solicitation materials
  - Consult with Delaware litigators regarding challenging the break-up fee and possibly challenging the "Force the Vote" provision
  - Speak with proxy solicitor regarding likelihood of success

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## EURODRUG'S ACTIONS

- **Announces Unsolicited Stock/Cash Tender Offer**
  - Premium – 25% for MicroPharm's Shareholders (vs. BioTron's premium of 10%)
- **Files Preliminary Consent Solicitation with the SEC to replace the Board**
- **Brings action in the Delaware Chancery Court**
  - Challenges the Break-up Fee structure and the "Force the Vote" provision

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### SCENE #3

#### What Do We Do Now?

The Board of Directors of MicroPharm discusses its response to EuroDrug's unsolicited tender/exchange offer and consent solicitation with its counsel Mr. Outside Specialist.

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### DIRECTOR'S DILEMMA

- **BOD** – Asks what the response to the tender offer and proxy contest should be
- **OS**
  - Reminds the Board of its fiduciary duties to act in the best interest of the shareholders of MicroPharm and reviews the considerations in deciding whether or not to withdraw the Board's recommendation
  - Reviews the No-Shop provision including the fiduciary out and termination provisions of the Merger Agreement with BioTron
  - Explains that after a thorough evaluation of EuroDrug's Offer (including the use of professionals to provide expert assessments), the Board must act based on its determination of the attractiveness of the offer
  - Suggests that the Board should assess the likelihood of (i) shareholder approval of BioTron's deal in the face of a higher offer and (ii) success of EuroDrug's consent solicitation to remove the Board
  - Suggests that the Board should take control of the process but in any case carefully weigh its options
  - Explains that the Board could implement a short term Rights Plan (Poison Pill) (approximately 6 months)
    - Clarifies that the Pill may not restrict the shareholders' right to remove the Board and then dismantle the Pill

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### DIRECTOR'S DILEMMA

- **OS (cont.)**
  - The Board could implement an auction process to seek to maximize value offered by the two competing bidders
- **BOD**
  - Asks what standards/mechanics must be put into place to run an auction
- **OS**
  - Explains auction process and duty of implementing a fair process and that each step of the auction must be aimed at achieving the best price
- **BOD**
  - Questions whether it must accept the highest dollar value bid (including the present value of the contingent cash payment rights offered by BioTron) or whether it may take into consideration other items
- **OS**
  - Explains that the Board must seek to obtain the highest value reasonably available for stockholders and may take into consideration a variety of factors in deciding on the value maximizing bid, including: HSR and other regulatory approval risk, the likelihood of MicroPharm's shareholders approving the transaction and any financing risk

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