Takeover battles

Just say no

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When and how, exactly, can a company decline to be bought?

FOR firms with cash to spare, today's market for mergers and acquisitions looks tempting. Share prices are down, making targets look cheap. And the seizure in the corporate-debt market means there is little competition from private-equity outfits in any deal worth over $1 billion. If you are a target, meanwhile, things could scarcely be worse. No doubt your low share-price is the result of irrational, non-exuberant investors lumping you in with the rest—wrongly of course. But what can be done to fight off a hostile bidder?

On either side of the Atlantic, big companies are discovering to what extent they can say no. On February 11th Yahoo!, a pioneering internet company, turned down a takeover offer worth $44.6 billion from Microsoft. The software giant had made the bid public a week earlier in a “bear hug” letter designed to press Yahoo! into accepting. But Microsoft's bid, even at a 62% premium to the market price of Yahoo! shares at the time, “substantially undervalues” the company, Yahoo!'s board contended. In London Rio Tinto said much the same thing on February 6th when it rebuffed the latest offer, worth $147.5 billion, from BHP Billiton, a fellow mining giant.

Despite the similar reactions of the target boards, the two deals highlight big differences in takeover law on either side of the Atlantic. In Britain it is relatively straightforward. BHP has made a tender offer for Rio Tinto shares; if enough shareholders accept the offer, BHP will prevail, provided it wins antitrust approval.

Things are more complicated in America. For a start, Microsoft's letter to the board of Yahoo! does not constitute a formal offer, or oblige it to make one. Under British rules, such a letter would require a bidder to make a formal offer by a deadline, as in BHP's case. That said, going public with a letter in the way Microsoft has done is not without risk, as it may alert other potential buyers. But Microsoft appears to have concluded that publicising the premium it is willing to pay for Yahoo! is more likely to scare off other bidders.

Yahoo! has several options, depending on how determined it is to maintain its independence. Two decades ago the courts in Delaware ruled that a board could “just say no” to an offer it did not like, for whatever reason and however much shareholders disagreed, and that would be the end of the matter. But a series of court cases, and the growing power and activism of America's institutional shareholders, have reduced the board's freedom of action since those heady days.

In today's litigious climate, Yahoo! must at least go through the motions of demonstrating that its decision to reject the bid is being done in the best interests of its shareholders, which means plenty of work for its investment bankers as they explain why the firm's low share price is an aberration, and why Microsoft's (non-binding) offer is not as generous as it looks.

Yahoo! has also been considering a defensive tie-up with Google, AOL or News Corp to keep Microsoft at bay. Failing that, it could encourage the antitrust authorities to intervene, as PeopleSoft did in 2003 when a rival software firm, Oracle, launched a

hostile bid. Microsoft has been the target of the trustbusters before, after all. But it is a high-risk strategy, for if the buyer then makes a new offer that the board wants to accept, the antitrust authorities may not go away.

Yahoo! might also try another of PeopleSoft's tactics: using a “poison pill” scheme to issue new shares and make a takeover impossibly expensive (which is banned in Britain). The legality of doing this when most shareholders want to accept a bid is not as clear as it was: an attempt to have PeopleSoft's poison pill thrown out might have had a good chance of success, but the case was not decided in court because PeopleSoft bowed to its shareholders and accepted Oracle's bid.

Most lawyers think that, one way or another, Yahoo!'s board will have to accede to the wishes of its shareholders, many of whom seem to be keener on squeezing a slightly higher offer out of Microsoft than scaring it away. In a letter on February 10th Bill Miller of Legg Mason, the second-largest shareholder in Yahoo!, said that his valuation of Yahoo! was in the region of $40 a share (compared with the $31 now on offer) and that he expects Microsoft to “do what it takes”. In short, by saying no, Yahoo!—like Rio Tinto—is probably just playing hard to get.