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UNSOLICITED TAKEOVER BIDS: LESSONS FROM THE PPG – AKZONOBEL SAGA

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Legal Briefings – By **Baden Furphy** and **Kimiyo Lee**

Leading Dutch paint maker, AkzoNobel, recently rejected three unsolicited takeover offers without any form of engagement with its bidder. Dissatisfied with the company's response, a group of AkzoNobel shareholders led by activist investor Elliott Advisors initiated legal proceedings against the company. In this article, we explore how a similar situation would play out in Australia, and highlight the potential for activist shareholders to seek to play a significant role in the outcome of takeover transactions.

IN BRIEF

- Dutch paint maker, AkzoNobel, recently rejected three unsolicited takeover offers from its US competitor, PPG, without any form of engagement with its bidder, and despite several public calls from a number of its shareholders to do so.
- Dissatisfied with the company's response, a group of AkzoNobel shareholders led by activist investor Elliott Advisors initiated legal proceedings against AkzoNobel in an attempt to remove the Chairman of the Supervisory Board.
- Set in a foreign context, this case begs the question of how a similar situation would play out in Australia, and what duties are incumbent on target directors in the face of takeover proposals.
- The target shareholders' litigious response also highlights the potential for activist shareholders to seek to play a significant role in the outcome of takeover transactions.

THE PPG-AKZO NOBEL SAGA

PPG'S TAKEOVER OFFERS

In a span of three months, PPG Industries (**PPG**), a leading global paints and coatings player, made three unsolicited offers to merge with Akzo Nobel N.V. (**AkzoNobel**), the Dutch owner of the Dulux paint brand.

In March 2017, PPG made its first proposal, offering AkzoNobel a 30% premium to AkzoNobel's then share price. The bid valued AkzoNobel at €22.4 billion. The proposal was conditional on various matters, including due diligence, reaching agreement on the merger documentation and the support of the Boards of AkzoNobel (it has a Board of Management and Supervisory Board). This was swiftly rejected by AkzoNobel's Boards on the basis that it:

- undervalued the company; and
- did not adequately address (1) wider stakeholder concerns, (2) significant deal risks and uncertainties, and (3) the cultural gap between the companies.

Subsequently, PPG returned with a second improved offer which was also rejected on the same grounds. Relentless in its bid for AkzoNobel, PPG floated a third offer, notably with a price tag of €26.9 billion, representing a 50% premium to AkzoNobel's then share price. PPG also included a lengthy appeal to the target's shareholders with regards to the synergies of the combination, made greater commitments to employee retention, research and development, retention of key operations in the Netherlands, sustainability and proposals on how to tackle the deal uncertainties and risks. It also offered to agree to a substantial break fee (if anti-trust approvals could not be secured). Again, this third offer was rejected.

AkzoNobel's Boards felt that the offers were "not in the best interests of its shareholders and other stakeholders", and insisted that PPG's offers did not even warrant any engagement with PPG. Instead, the Boards announced plans for AkzoNobel to unlock value within itself organically, and bring forward plans to spin-off its speciality chemicals business – a move also designed to allay deeper investor concerns over AkzoNobel's stagnated growth and poor share price performance.

SHAREHOLDER PRESSURE

Although AkzoNobel's major shareholders generally agreed with the Boards' view that the first and second offers were inadequate, there was strong sentiment that they warranted discussions with PPG to seek to maximise shareholder value. However, the only form of dialogue between PPG and AkzoNobel throughout the entire process comprised a short meeting after the third offer, which PPG claimed to be absolutely meaningless and not genuine as AkzoNobel gave less than 24 hours' notice for the meeting, stipulated the meeting be held in Rotterdam, and at the meeting, maintained that they did not intend, or have authority, to negotiate with PPG.

The mounting shareholder pressure to engage in takeover talks with PPG resulted in calls for a shareholder EGM to be convened to consider the Boards' failure to have discussions with PPG and the removal of the Chairman of the Supervisory Board. This request was declined by the company on grounds that it did not meet the 'legitimate interest' test required by Dutch law.

FORMAL LEGAL ACTION

A number of AkzoNobel's shareholders continued to pursue the case for engagement with PPG by commencing litigation against AkzoNobel. Led by activist fund Elliott Advisors, the Dutch commercial court was petitioned to make inquiries into the company's conduct and policies for breach of directors' fiduciary duties and Dutch corporate law, and impose an interim measure to convene an EGM for shareholders to vote on a resolution for the removal of the Chairman of the Supervisory Board.

DECISION OF THE DUTCH COURT

The court rejected the shareholders' legal challenge and found no breach of fiduciary duties or corporate governance rules by the AkzoNobel Supervisory Board, and therefore, found no need for an EGM. It was held that there was no general duty on a target company board to consult with shareholders or negotiate with bidders in takeover situations.

While the Boards of a company are ultimately accountable to shareholders for their conduct and decisions, it is the Management Board's responsibility (supervised by the Supervisory Board) to set company strategy and make decisions in relation to such strategy. As such, the authority to decide on a company's response to an unsolicited takeover proposal falls squarely on the Board.

THE CONCLUSION OF THE SAGA

PPG announced in June that it was withdrawing its takeover proposal for AkzoNobel after three failed attempts. This announcement was preceded by a final attempt for engagement after the third offer was rejected, where PPG again sought to address AkzoNobel's concerns around value, certainty, timing and stakeholder considerations. Interestingly, PPG offered additional commitments and assurances, including an offer to negotiate a nominal price increase on top of the third offer price, and a 'ticking fee' payable to AkzoNobel shareholders if completion of the deal was not achieved within 15 months of signing.

HOW WOULD THIS PLAY OUT IN AUSTRALIA?

DUTY TO ENGAGE OR NEGOTIATE WITH BIDDER?

The power to manage the affairs of a company in Australia is vested in the board of directors. While directors are conferred wide powers in relation to the management of a company, they are under strict fiduciary and statutory duties. Traditionally, courts have been reluctant to question the commercial merits of a decision taken by the board or interfere with business decisions where it can be shown that the directors have exercised care and diligence, acted in good faith and not used their powers for an improper purpose. This is also evident in the nature of the test applied to the business judgment rule contained in the *Corporations Act*.

In light of the above, there is no general duty on a target company board to engage with a bidder in takeover situations in Australia, and a similar non-interventionist line taken by the Dutch commercial court would likely be adopted. A bidder whose change of control proposal is rejected by the target is generally free to make an unsolicited takeover bid if it feels the proposal is compelling for shareholders, so non-engagement by the target does not preclude a change of control transaction. This is not to say that there will never be situations where the factual matrix would give rise to a duty to engage and, of course, a decision not to engage with a bidder must be made after a careful assessment of the proposal (see below).

Conceptual issues

Conceptually, it is unclear what a duty to engage would entail and what the ambit of such a duty would be. Would a meeting similar to that initiated by AkzoNobel where little notice was given to PPG and minimal mandate and authority given to make decisions be sufficient to discharge a duty to engage with the bidder? What form must engagement take? These questions suggest that a duty to engage is in itself a somewhat troubling and nebulous concept, and is unlikely to be of general application.

Interestingly, in the PPG – AkzoNobel case, PPG made two material improvements to its proposal despite AkzoNobel's refusal to engage. This fact pattern might be taken to support the approach adopted by many target companies that they will not engage with a bidder, or provide due diligence access, until the indicative price offered is acceptable. A contrary argument in this case is that it may have been possible for AkzoNobel and PPG to resolve or at least narrow the scope of disagreement on some of the qualitative aspects of PPG's offer through discussions, such as the level of risk associated with anti-trust approvals.

Practical considerations

From a practical perspective, it is crucial that a target board is able to justify its decision not to engage with a bidder. It must be able to demonstrate that the decision not to engage in dialogue with the bidder is in the best interests of the company, and such decision was taken with care and diligence, and in good faith. What this entails will differ in each case, but would centre around factors which show that the board has seriously considered the proposals such as:

- the intensity and frequency of board meetings to consider the takeover proposal;
- assistance from external financial and legal advisers; and
- the range of topics considered when rejecting the proposal e.g. value, timing, certainty, stakeholder considerations.

STAKEHOLDER INTERESTS

In rejecting PPG's proposals, the Boards of AkzoNobel took into account the interests of a wide range of stakeholders. These included the interests of employees (employee unions were strongly opposed to AkzoNobel being acquired by PPG), the importance of AkzoNobel's operations to the Dutch economy (the Dutch Government opposed the transaction) and the impact of the transaction on AkzoNobel's research and development program. Would a similar approach in Australia be acceptable?

The duty of Australian directors to act in the best interests of the company is an overarching duty. In the normal course of business, the best interests duty is probably sufficiently flexible to allow directors to consider the interests of other stakeholders such as employees, customers and suppliers. However, in the takeover context, particularly given Australia's takeover regulatory framework, the interests of target shareholders are generally regarded as paramount (an often difficult aspect for target company directors is balancing the interests of shareholders with different perspectives, such as those with a long-term investment horizon versus short-term investors). It is not feasible for target company directors to prioritise non-shareholder interests over shareholder interests in responding to a change of control proposal.

RELATIONSHIP WITH SHAREHOLDERS

While target company directors might be entitled to decide not to engage with a bidder, one practical consideration directors must bear in mind is the strain such conduct can put on the relationship with investors, and how the company will mend the fence with its key stakeholder after such an episode. Therefore, despite the legal position, target company directors do often seek the views of shareholders and take those views into account in determining their response to a takeover proposal.

For example, how does AkzoNobel's move impact its plans to spin-off an existing business unit where significant shareholder buy-in is required? It also places significant pressures on the management to execute the alternative plan, and avoid an Astra-Zeneca-like situation where the UK pharmaceutical group's shares never traded above the price Pfizer was willing to offer. These types of considerations led the Dutch court to expressly reference the strained relationship between AkzoNobel and a number of its shareholders, and urge AkzoNobel to take action to remedy this.

SHAREHOLDER ACTIVISM

Shareholder activism is not a foreign concept in the Australian corporate landscape and target shareholders have often been vocal in expressing their views about takeovers. However, the PPG – AkzoNobel story brings shareholder activism in a takeover situation to a new level. The shareholders sought to play a significant role in the outcome of a takeover transaction, and went as far as initiating litigation against the very entity they are invested in.

Under Dutch law and the constitutional documents of AkzoNobel, the shareholders were not able to 'force' a shareholder vote on the removal of the Chairman of the Supervisory Board, even though the shareholders that commenced the litigation held around 20% of AkzoNobel's shares. In the Australian context, a shareholder holding 5% or more of the shares in the target company could requisition a shareholder meeting to vote on changing the target's company board. This provides activist investors with a clear pathway to seek to influence the outcome of takeover transactions.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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