

The “Pac Man” Defense Makes a Return Appearance

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The recently launched Pac Man counteroffer by The Men’s Wearhouse, Inc. in response to a prior unsolicited offer by Jos. A. Bank Clothiers, Inc. provides a good opportunity to review the use and legal implications of the colorfully named but rarely used takeover defense.

BACKGROUND: THE MEN’S WEARHOUSE/JOS. A. BANK SITUATION¹

In early October 2013, Jos. A. Bank, a major competitor of The Men’s Wearhouse, made an unsolicited proposal to acquire The Men’s Wearhouse for \$48 per share in cash for a total of approximately \$2.3 billion. That proposal was rejected by the board of directors of The Men’s Wearhouse, stating that it significantly undervalued the company and its recent growth initiatives. Although Jos. A. Bank terminated its unsolicited offer, on November 26, 2013, The Men’s Wearhouse submitted a counter-proposal to acquire Jos. A. Bank for \$55 per share in cash for a total of approximately \$1.2 billion. The “Pac Man” counteroffer was rejected by the board of directors of Jos. A. Bank. The Men’s Wearhouse subsequently commenced a tender offer to acquire Jos. A. Bank for \$57.50 per share in cash and has announced its intention to nominate two independent director candidates for election to Jos. A. Bank’s board.

PRIOR EXAMPLES OF THE PAC MAN DEFENSE

Besides The Men’s Wearhouse’s counteroffer, there have been only a handful of cases where the Pac Man defense was actually employed. The tactic was first used in 1982 by Martin Marietta Corp. in response to an unsolicited offer by Bendix Corp. Bendix had successfully acquired a majority of Martin Marietta’s common stock when Martin Marietta launched a “Pac Man” counteroffer for Bendix. The takeover fight ended when Bendix was acquired by a white knight purchaser, Allied Corp., in early 1983. Other uses of the Pac Man defense include the following:

- *Citgo/Mesa Petroleum* (1982): Citgo, an Oklahoma oil company, responded to Mesa Petroleum’s takeover offer with a partial tender offer for 37% of Mesa Petroleum’s stock. Citgo successfully acquired a sizable amount of Mesa Petroleum’s stock and reduced the threat of Mesa Petroleum’s takeover. Shortly thereafter, Citgo was acquired in a friendly deal by Gulf Corp.
- *American General Corp./NLT Corp.* (1982): Insurance company American General Corp. launched a hostile takeover of its rival NLT Corp. When it could not find a white knight acquirer, NLT launched its own hostile counteroffer for American General. The takeover fight continued for several months, and American General eventually submitted a two-tiered offer to buy NLT for \$38 per share in a hostile transaction or \$46 per share if NLT’s board endorsed the transaction. NLT’s board agreed to endorse the transaction and American General acquired NLT.
- *American Brands, Inc./E-II Holdings Inc.* (1987-88): E-II Holdings Inc., a consumer products company, proposed to acquire tobacco holding company American Brands, Inc. for \$6 billion. American Brands responded with its own takeover offer and successfully acquired E-II for \$1.1 billion. American Brand’s takeover of E-II was the first “Pac Man” counteroffer in which the counter offeror successfully acquired the initial offeror.
- *Wolverhampton & Dudley/Marston, Thompson & Evershed* (1998): British brewery Wolverhampton & Dudley launched a hostile takeover of its competitor Marston, Thompson & Evershed after a friendly takeover of Marston had failed. Marston then launched a “Pac Man” counteroffer against Wolverhampton. After raising its initial bid and acquiring 73.5% of Marston’s shares, Wolverhampton

¹ For a detailed account of the events surrounding the The Men’s Wearhouse/Jos. A. Bank situation, see <http://www.mofo.com/files/Uploads/Images/UV-Mens-Wearhouse-Jos-A-Bank.pdf>.

ultimately won the takeover fight. Marston's counteroffer marked the first use of the Pac Man defense outside the United States.

- *TotalFina/Elf Aquitaine* (1999): French oil company TotalFina made a \$43 billion stock bid to acquire rival Elf Aquitaine. In response, Elf Aquitaine made a \$51 billion cash-and-stock counteroffer to acquire TotalFina. In September 1999, TotalFina acquired Elf Aquitaine in a friendly transaction after TotalFina increased its purchase price.
- *Shorewood Packaging Corp./Chesapeake Corp.* (1999): Shorewood Packaging Corp. made a \$480 million bid to purchase Chesapeake Corp., a rival packaging company. In response, Chesapeake made a counterbid against Shorewood and successfully purchased a 15% stake in Shorewood. Chesapeake remained independent.
- *BHP Billiton Ltd./Rio Tinto PLC* (2007): After BHP Billiton Ltd. made an unsolicited bid to acquire Rio Tinto PLC for \$131.6 billion, Rio Tinto considered launching a Pac Man defense but ultimately decided against it. BHP's offer was later withdrawn.

LEGAL CONSIDERATIONS

The use of the Pac Man defense presents certain legal risks and complications. Because of its limited use, courts have provided only limited guidance on the legitimacy of the Pac Man defense. In the only two instances in which U.S. courts have ruled on this matter, they have reviewed and upheld the use of the Pac Man defense under the business judgment rule.² In particular, in *American General Co. v. NLT Corp.*, the court found that "although its origins were in a strategy to defend against American General's exchange offer for NLT, NLT's counter tender offer was decided upon as the best alternative available to NLT and its shareholders and is a *bona fide* tender offer." Both cases pre-date the Delaware Supreme Court's decision in *Unocal v. Mesa Petroleum*, which first articulated the standard that defensive actions need to be reasonable and proportionate to the threat to the target company. The Delaware courts have never examined the Pac Man defense under the *Unocal* test. Given the limited jurisprudence on this matter, it is possible that courts in the future may view the Pac Man defense as falling under the *Unocal* framework for defensive actions, which would mean that the board of directors would have to show that the counteroffer was proportional and reasonable given the nature of the threat.³

Courts have also ruled that the Pac Man defense is not manipulative under Section 14(e) of the Williams Act.⁴ In the Bendix-Martin Marietta situation, Bendix claimed that Martin Marietta's offer represented a "scorched earth" tactic that was manipulative against Bendix's bid to acquire Martin Marietta, and thus, was in violation of the Williams Act. The Court found that, under Section 14(e) of the Williams Act, such a counteroffer can be found to be manipulative only if misrepresentations or omissions have been made about the offer.

In addition, the Pac Man defense may be problematic in certain cross-ownership situations. Certain states' laws may in fact prevent stockholders from voting to approve a Pac Man defense transaction. For instance, Delaware General Corporation Law provides that a subsidiary owning stock in its parent may not vote such stock.⁵ Consequently, in a situation where the target of an original bidder's initial offer launches a Pac Man defense to acquire the original bidder, an issue may arise as to whether the target, after it becomes a subsidiary of the original bidder as a result of the original bidder's initial offer, can vote the shares of the original bidder as parent of the target to approve the Pac Man transaction. It is theoretically possible that a deadlock situation could occur in which a majority of the stock of each party would lose its voting rights. The Delaware Chancery Court touched on this issue in the context of Martin Marietta's counteroffer against Bendix and preemptively enjoined Martin Marietta from voting any Bendix stock it might acquire in its counteroffer because Bendix's ownership of Martin

² See *American General Co. v. NLT Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 98,808 (S.D. Tex. July 1, 1982); *Martin Marietta Corp. v. The Bendix Corp.*, 549 F. Supp. 623, 633–34 (D. Md. 1982).

³ See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

⁴ See *id.*, at 627.

⁵ Del. Gen. Corp. Law § 160(c).

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Marietta at the time of the counteroffer rendered Martin Marietta a Bendix subsidiary under the Delaware General Corporation Law.

Finally, and perhaps most importantly, the use of the Pac Man defense may hinder or even eliminate other viable defensive tactics. For example, the counter-bidder can no longer credibly question the business logic of the combination once it has made its own offer to put the companies together, or complain about its potential antitrust or regulatory implications. Employment of a Pac Man defense is an implicit agreement that a combination with the initial acquirer is favorable and in the best interest of the counter-bidder's stockholders.

It will be interesting to see whether courts will provide additional clarity on the legal regime applicable to the Pac Man defense in connection with The Men's Wearhouse's counteroffer and whether the tactic will become more widely used if The Men's Wearhouse is successful in its counteroffer to acquire Jos. A. Bank.

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