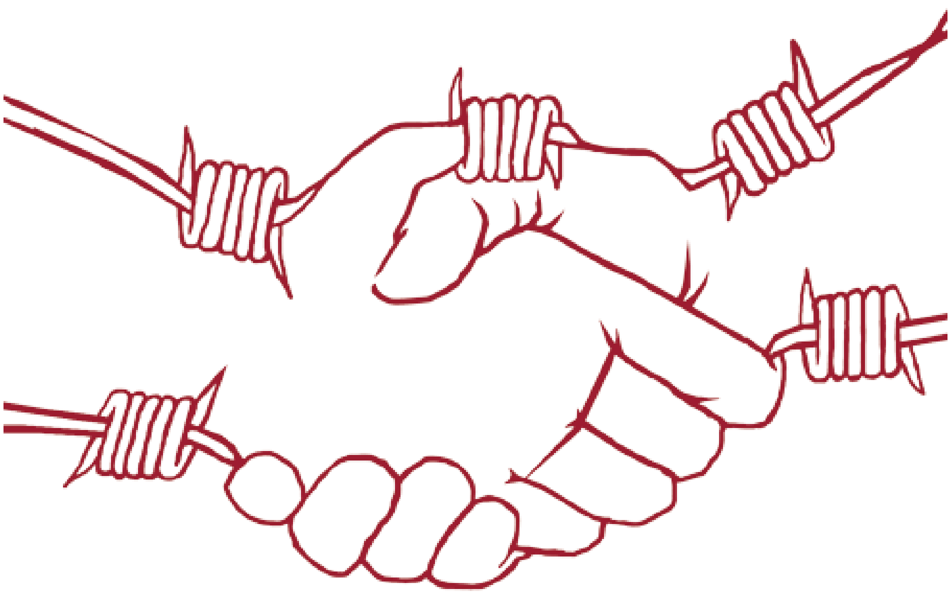

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Ten Ways to Maintain Board Unity During a Hostile Takeover

By Lola Gershfeld

On April 21, 2014, Allergan received a merger offer from Valeant. Though the offer was higher than the stock price, the Allergan board unanimously rejected it, reasoning that the offer did not reflect the intrinsic value of Allergan's stock. In response, Valeant pursued a hostile takeover bid supported by a Pershing Square investor who had acquired a 9.7 percent stake in Allergan two months prior to the offer. Allergan's board worked to protect the company and its shareholders, working together over a seven-month period, ultimately prevailing when Allergan merged with a different company, Actavis, in March 2015.

Michael R. Gallagher is the lead independent director of Allergan's board and helped guide the company through this highly publicized hostile takeover bid.

"Everyone wants to do the right thing, but it takes courage to actually do it, which can be challenging," Gallagher told me in a recent phone interview. "I am very proud that our board was able to show that remarkable courage during a very difficult time."

Allergan's success was not the result of luck or coincidence, but rather the company's unshakable core values, sound business judgment, leadership, and board dynamics. Directors and their boards can learn from Allergan's experience when dealing with an activist investor.

Overcoming Emotions

A hostile takeover bid can elicit a variety of emotional responses in each director on a board, but perhaps the most universal is that hardwired "fight-or-flight" response that automatically kicks in when danger of any ilk is present. But even if this biological panic button has been pressed, when board members feel secure with each other, they are better equipped to stand united when facing this type of situation. My conversation with Gallagher about Allergan's board culture and dynamics revealed the following 10 steps that boards can follow to help ensure similar strength and fortitude during times of high stress.

Step 1: Remove obstacles to boost transparency. Allergan's board meetings were structured to promote a safe environment for sharing ideas and concerns. This was good preparation for the board in dealing with uncertainties.

"We would always start with committee meetings, followed by a board meeting with all directors and senior management," says Gallagher. "After that, we would have an executive session, first with the CEO and then without the CEO present. The latter session tended to be more open, enabling directors to speak up and ask uncomfortable questions. For example, outside investors wanted to hear from other board members, but ultimately, we decided that it was best for us to select one spokesperson, and it was our CEO."

Having these types of discussions without the CEO present gave directors the freedom to speak openly and make fully informed decisions. Directors must have an environment that provides a sense of emotional security so that they can share sensitive concerns and information, which in turn enables the forging of strong personal and business connections.

"On many occasions, when directors needed more information it was communicated to the CEO, and he provided whatever was requested without reservation," Gallagher notes. This allowed directors to make informed and fact-based decisions, and reinforced a sense of trust and comfort with the disclosed information.

Step 2: Validate differences to foster acceptance. Allergan's directors followed Gallagher's lead to create an environment where different opinions were heard and respected. Gallagher established an active engagement process to increase the frequency of interaction. He also made sure to incorporate the same process during the merger evaluation and strategic decision making. Eliminating concerns about being judged is an important component in fostering effective board dynamics.

"We made sure that everyone was engaged, actively participated in discussions, and felt comfortable with the information provided at all times," Gallagher explains. "When there were differences, others were encouraged to respect those views."

The need to be heard goes back to an innate desire to belong. Research shows that there is a strong correlation between feelings of belonging and cognitive functioning. Feelings of belonging are fostered when directors experience frequent comfortable interactions and share a sense of genuine concern for each other's welfare. Research also reveals that a feeling of belonging encourages people to take healthy risks, such as pursuing new experiences, learning new skills, and trying out new ideas.

Step 3: Validate and protect shared principles. Allergan's directors were able to withstand a firestorm of personal attacks by continually reaffirming their common goal of thwarting the takeover. This tactic enabled the board to remain united.

"Allergan's investors and members of the media did everything in their power to try to divide our board," Gallagher recalls. "We were attacked with name-calling and criticized for not being independent thinkers. Many external forces pressured us to give in, but the board understood that the deal was not in the best interests of the company and its shareholders, and stood steadfast as we focused on what's important."

One of the manipulative tactics often used to influence others' decisions is public shaming. Shame is one of the most insidious causes of dysfunction on a board, and can cause directors to think that they aren't smart or capable enough to effectively serve in their roles. These mass feelings of self-doubt not only cause stress but also impede rational thinking—and not succumbing to these feelings when attacked can be a challenge. In contrast, when a board member has the strong support of the other members—and they share values and goals—the attempts of others to induce shame can be more easily deflected.

Step 4: Maintain engagement and the flow of information. Allergan's board set a demanding agenda to deal with the hostile takeover attempt. Over the course of 28 weeks, between April 21 and November 6, 2014, Allergan's nine-member board held 41 board meetings. Every single director was present at all but one of the 41 meetings. Many of them had to rearrange their schedules, as they were based in or traveling from various parts of the world.

To keep directors actively engaged, Gallagher asked each board member to state his or her position on the issues at hand at the start of select board meetings. The directors thoroughly embraced this process. When issues were unclear, supporting materials and explanations were presented, followed by further discussion, until each director felt sufficiently informed and self-assured to make a decision. This process reinforced the entire board's engagement and participation. At the end of each meeting, every decision was reached by a unanimous vote.

Mandatory engagement ensures a fair process by giving each board member an opportunity to speak, to be heard, and to be understood. This approach ensures power is balanced among the directors while enhancing trust, cooperation, and respect. The perception or reality of unequal positions of influence among directors may contribute to an environment that feels emotionally unsafe and hostile. Gallagher's practice of encouraging directors to share their opinions implicitly acknowledged each director's expertise and value. This strategy created an environment where directors felt comfortable articulating their impressions, views, and concerns. Being heard is an important part of a functioning and dynamic board.

The decision-making process becomes more balanced when standards of equal opportunity to express one's opinions are in place. Stress is consequently reduced for directors who may have felt intimidated or unsure. When Allergan's directors knew that they would be expected to share their views, they were more attentive, focused, and engaged in the decision-making process. When people know that individual

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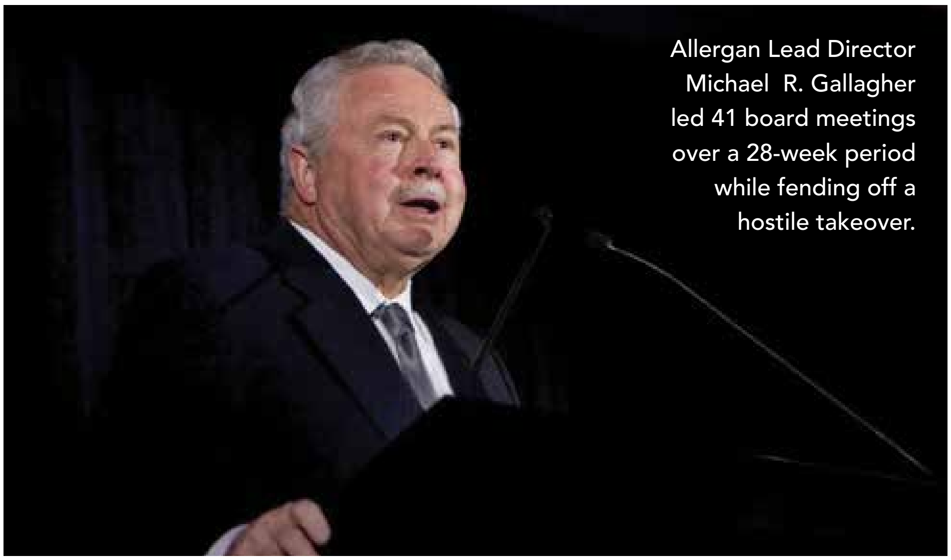

Allergan Lead Director Michael R. Gallagher led 41 board meetings over a 28-week period while fending off a hostile takeover.

COURTESY OF FORUM OF CORPORATE DIRECTORS

contributions will be recognized and valued, they are more willing to set aside their own personal interests for the good of the group. This ethos also enables the group to be more attuned to the thoughts and feelings of others, can help directors better sense each other's emotions, and often heightens their sense of belonging. These enhanced human connections are key in uniting people to strive toward a common goal.

Step 5: Regularly assess each director's emotions. Part of Gallagher's strategy in response to the attacks from media and investors was to hold private conversations with each board member to assess his or her emotional state and to provide a safe harbor. He was then able to help the directors refocus so that they could make decisions that would benefit the company.

Resentment and mistrust often develop when people suppress negative emotions, slowly disconnecting from the group. When directors are able to express their feelings of stress and know they are in an environment where they will be understood, the likelihood of initiating that fight-or-flight response significantly decreases.

As much as directors want to think that emotions don't belong in the boardroom, studies show that emotions drive many of the decisions made there. For example, whether a person is excited about an opportunity or faces seemingly insurmountable obstacles, strong emotions can distort their perceptions of reality. To counter this, leaders who know how to recognize and address emotions at the right time are able to keep the team engaged and focused on the tasks at hand.

Step 6: Embrace the power of empathy. Gallagher wanted to make sure that directors felt understood and accepted by validating each person's worries and doubts. This approach proved to be powerful in working through less-than-optimal business conditions, resolving conflicts, and helping directors better manage their emotions and focus on the job at hand.

The power of empathy is not to be underestimated in these situations. For example, research by Dr. Brené Brown, a research professor at the University of Houston Graduate College of Social Work, finds that empathy is instrumental in reducing feelings of shame and isolation. Brown asserts that shame and isolation grow on secrecy, silence, and judgment. Shame and isolation can't survive absent these conditions. "We [didn't] want to go for two weeks without another meeting," Gallagher recalls. The fact that the board wanted to meet often confirmed that the directors embraced the interaction, openness, and transparency during these meetings which provided them the support and reassurance that they were all focusing on the same goal.

Step 7: Hire independent counsel for your board. Independent counsel attended many of Allergan's board meetings. The attorney provided clarity regarding the directors' fiduciary responsibilities during key decision-making junctures, enabling them to feel confident that their decisions were not knee-jerk reactions to the crisis at hand but instead based on sound business judgment.

Directors come to a board with various business backgrounds and skills and disparate levels of experience. Some of Allergan's directors did not have previous experience with a hostile takeover attempt. Thus, the fight held a different meaning for each of them and prompted different levels of anxiety. Thoughts such as "I could be held personally liable and possibly put my family in financial danger" and "What happens if I were to be sued?" could steer directors away from making the best decisions. Some directors feared being sued and possibly losing their life savings as a result of this takeover bid. Legal counsel helped to manage those feelings by reiterating that unless the board did something irresponsible or reckless, it was highly unlikely that individual members would be charged with a breach of fiduciary duty or held personally liable for any adverse outcomes for shareholders. Directors were nevertheless advised of different scenarios that could lead to having to pay damages to a plaintiff. This type of clarity helped directors review all possible options.

When these kinds of issues were raised with Gallagher outside of a board meeting, he made sure to bring them to the forefront at the next meeting, asking outside counsel to provide legal direction to address such concerns. The attorney eased directors' minds by explaining the protection of directors established by case law within Delaware's courts. This process encouraged directors to raise uncomfortable questions or could have put them at risk of making decisions that were not in Allergan's best interests.

Step 8: Precondition your board. Allergan's board held annual reviews of legal terminology surrounding hostile bids and discussed the protocols that needed to be followed in such cases. This training prepared them for such scenarios and minimized the risk of being blindsided by the unexpected.

Preconditioning enables our brains to continue to function during times of stress, and when a person practices a suitable response to a particular stressor, he or she is able to rely on that response even if his or her logical reasoning is temporarily disabled during a sudden attack. The more time directors spend exploring different alternatives in advance of difficult situations, the easier it becomes to respond to them as a united group.

Once faced with a hostile bid, Allergan recruited Cary Hyden of Latham & Watkins to help the directors understand the technical details of Valeant's offer. Not only did the firm have extensive experience with mergers and acquisitions, but throughout the process of acquisition, Hyden and his team provided continuous support to directors by being available for consultation from 5 a.m. until 9 p.m. every day of the week. These two factors allowed directors to maintain a sense of control over the situation. In addition, Hyden prepared the board for the likelihood of being judged, criticized, and bullied by the media and some shareholders, allowing directors to prepare themselves for negative responses, be on guard for feelings of shame and fear, and better manage negative emotions.

Step 9: Build strength through courage. A hallmark of Gallagher's style is consistently modeling the kind of strong interpersonal relationships that build bonds between directors and help each person to avoid ruminating on possible negative outcomes. This ultimately gave the board as a whole the courage needed to take the types of risks that would lead to the best result for the company.

The combination of uncertain outcomes and anxious anticipation of a pending acquisition can be excruciating. Research shows that the anticipation of danger or harm causes more anxiety than actually facing the worst-case scenario. When under stress, people may adopt a posture of defensive pessimism, in which they reduce their expectations of success by imagining the worst-case scenario in order to motivate themselves to take appropriate actions in the hope of avoiding that scenario. By encouraging board members to share their concerns, and then explaining why each scenario was unlikely to materialize, directors were able to maintain a positive outlook.

Step 10: Reinforce achievable outcomes. Hiring financial analysts to evaluate and present concrete information about the true value of Valeant's offer allowed the board to make business judgments based on facts, not opinions. Financial analysts added to the information provided by outside counsel, who clarified fiduciary duties of loyalty and care.

Together, these resources gave the board information about what was financially best for the company, along with the reassurance that pursuing that goal would not unreasonably expose the directors to personal liability.

Allergan's directors formed such strong bonds with each other that there was a mutual sense of loss when Valeant's challenge was resolved, similar to the let-down stage actors feel when they have completed a show's run.

"It was a bittersweet deal," remembers Gallagher. By working together for Allergan's future, directors fostered cooperation, loyalty, and trust that made it possible to resist the hostile takeover attempt. Reinforcing that a better outcome was achievable and providing concrete details of what that better deal would look like were key steps in that process.

The Actavis Acquisition

Allergan's experience clearly demonstrates that boards can accomplish difficult tasks by working together to create a constructive environment for each other, strengthen their connections, and develop mutual trust.

Valeant's initial offer was $45.6 billion; it was later increased to $53 billion. Despite the pressure Allergan's directors faced, including personal attacks levied by multiple segments of the public, they stayed on track and remained collectively strong and focused on finding a better option.

Actavis acquired Allergan in March 2015 for about $70.5 billion in cash and stock, with the combined company taking the name Allergan. The $25 billion in additional value that shareholders received in the deal says a lot about how well the board was served by applying the aforementioned principles. D

Lola Gershfeld, PsyD, is a board dynamics specialist at Level Five Executive Inc., in Newport Beach, California. She is the author of the *Effective Board Dynamics Guide for CEOs and Directors* (Level Five Executive Publishing, 2016). She can be reached at lola@levelfiveexecutive.com.