Allergan (AGN)— Consent Solicitation by Pershing Square to Call a Special Meeting

ISS Recommendation:

PROVIDE CONSENT to call a special meeting

Executive Summary

Valeant Pharmaceuticals, which had been wooing Allergan privately since 2012, went public in April 2014 with a cash-and-stock offer. On May 30, the date of Valeant's most recent increase to its offer, the market value (using closing prices of the previous night) was approximately $181, a 55% premium to the unaffected Allergan share price.

Pershing Square, the company's largest shareholder, is also a co-bidder with Valeant, and purchased its 9.7 percent stake in March and April as a toehold to help drive a transaction.

Allergan's board has consistently rejected Valeant's offer as undervalued, arguing the company is worth more stand-alone.

Pershing Square is now soliciting consent from at least 25 percent of outstanding shares to call a special meeting. At that special meeting, shareholders would vote on proposals to

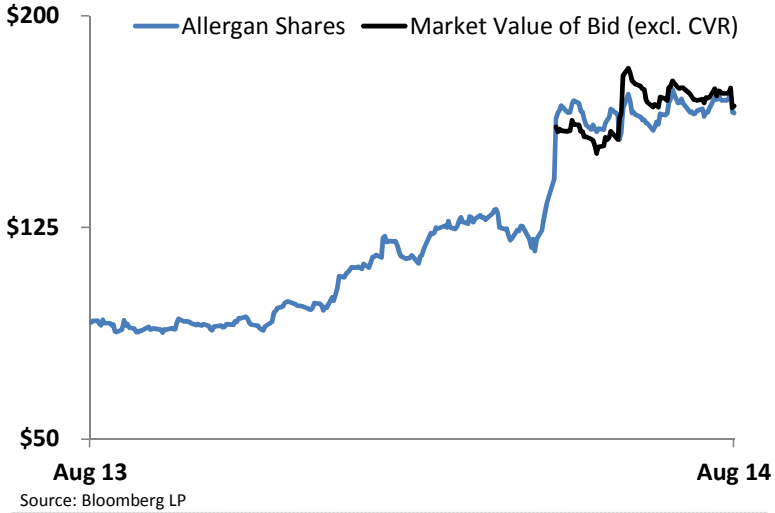
1) fix the special meeting provisions in the bylaws, which Pershing Square believes are "unduly onerous and anti-shareholder," and
2) remove and replace a number of directors such that the reconstructed board is more likely to "engage with Valeant."

While Pershing Square's economic incentives are congruent with those of other shareholders—the value of its holdings increases if the offer increases, or if the incumbent board can convincingly demonstrate that a standalone alternative will yield higher value than a buyout—it remains prudent for each shareholder to consider the arguments for and against calling a special meeting on their own merits, regardless of the conclusions the company's largest shareholder has reached.

In particular, shareholders should consider whether calling a special meeting now would allow them an opportunity they would not otherwise have to address significant issues at the company, regardless of whether they ultimately agree that the company should be sold.

CHART FOCUS

Share Price Performance



Source: Bloomberg LP

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 In the preparation of this report, ISS spoke with company management and certain shareholders.

Do governance issues suggest a special meeting is necessary?

In presentations to investors the board has asserted it has demonstrated a commitment to "good governance," noting that shareholders approved by overwhelming margins the board's binding proposals to allow for the rights to call special meetings (84.5% of votes cast at the 2013 annual meeting) and to act by written consent (80.4% of votes cast at the 2014 annual meeting). In an engagement meeting with ISS, the company asserted in particular that it has not heard any discontent from shareholders about the procedural requirements to call a special meeting.

Shareholders were only asked to vote, however, on the article amendment which granted these rights, and not on the thicket of procedural constraints imposed by the bylaws the board also adopted. The high shareholder support for the article amendments likely reflected shareholder belief that getting even a highly restricted right was preferable to not having it at all. The high withhold votes at the 2014 annual meeting against the Lead Independent Director (33.4 percent) and other members of the Governance Committee (11.7-11.9 percent) which oversaw development of the bylaw provisions, by contrast, appear to reflect deep dissatisfaction with the dichotomy between the mandate shareholders provided and the manner in which the board, in implementing that mandate, effectively undercut it.

Asked in an engagement meeting how the bylaw the board implemented was an appropriate response to the mandate shareholders had provided, representatives of the company asserted the board had tried to strike a balance between corporate democracy and the risk these rights might be misused. Asked how, specifically, requiring that all shareholders supporting a call for a special meeting provide two years of trading history helped strike that balance, representatives of the company averred that it was necessary to have "a process" for orderly exercise of these governance rights. Asked, instead, how requiring such extensive disclose every relationship between any "associate" of the shareholder—a term which apparently extends to the LLC through which the CEO of one shareholder owns a vacation home—and the company, its "associates," and its numerous competitors helped strike that balance, representatives of the company reiterated that the board believed in preventing potential misuse of these governance rights. Asked, further, how requiring each supporting shareholder transfer shares into record name and file an individual request for a meeting through Cede & Co, rather than use the omnibus proxy process which is customary in the industry (and apparently presents no issues for the company on any other proposal) helped strike that balance, representatives of the company averred that they were not familiar with every detail of the bylaw governing the calling of special meetings.

Asked once again, in summary, to reconcile how the extensive bylaw constraints the board had placed on the right to call special meetings was an appropriate response to a shareholder mandate, rather than an attempt to frustrate shareholders' exercise of their governance rights, the lead independent director offered that the board had been informed by its advisors that such bylaw constraints were common at other companies. Asked to provide the names of ten such companies, the company responded several days later with a fresh seven-page memo from its external counsel listing twenty companies with at least one similar provision in their bylaws, and laying out the Allergan board's rationale for each of the major procedural requirements it had implemented.

As a response to a request for ten names, the memo (subsequently filed with the SEC and available for all shareholders to review), is an impressively weighty thing, with no fewer than 16 footnotes substantiating matters of Delaware corporate law and correlating each procedural requirement with the appendix of twenty firms purported to impose substantially similar procedural hurdles on their shareholders who wish to call special meetings.

As a response to the deeper question of why Allergan's bylaw constraints were an appropriate response to the shareholder mandate to provide certain governance rights, by contrast, it appears to have been an exercise in concealing what was never worth finding: the Allergan bylaws are far more restrictive than any of the comparator companies the board apparently reviewed, with no discernable advantage for Allergan shareholders.

Less than half of the comparator companies, for example, have more than three of the constraints—and the constraints they do impose are overwhelmingly the least onerous for shareholders wishing to support the call for a special meeting: establishing blackout periods during which a special meeting may not be called, for example, or providing that shares sold by a supporting shareholder will be netted out of the total number of shares consenting to call the meeting, or in many cases requiring that the shareholder spearheading

the call for special meeting hold shares in record name. The list includes 16 S&P 500 companies, which might seem appropriate comparators—but also three microcaps and a midcap, apparently included to bolster the count of companies which have more onerous provisions. The three microcaps alone account for nearly half of the instances of shareblocking (3 of 8), additional information requirements (2 of 5), and "no similar items" (2 of 4) provisions. Only two of the twenty companies have more than 4 of these restrictions—and both of them are microcaps.

In calls with investors considering whether to support the request for special meeting, ISS heard repeatedly that the additional procedural and information requirements laid out by the Allergan bylaws imposed a significant burden, and the opportunity to eliminate them at this special meeting was increasingly becoming a meaningful reason to persist in calling the special meeting.

It is also a reason the board itself could have eliminated—and perhaps traded up to some good will from the shareholders it represents—by simply rescinding the bylaw restrictions.

Tactically, in the face of an unsolicited offer at a more than 50 percent premium to the unaffected trading price, such a move might seem ill-advised. But that tactical advice itself epitomizes "short term perspective." From a broader and more enduring governance perspective—a perspective, one might argue, distinctly appropriate for a board of directors, if not necessarily its advisors—enabling the owners of the company real access to the governance rights granted them in the articles of incorporation would clearly be the appropriate response.

One might object, reasonably enough, that good governance also involves asking what unintended risks or consequences shareholders might face if these unusual and unnecessary constraints on the right to call special meetings were eliminated. The answer appears to be that, at this company and at this moment in time, shareholders would likely be faced with a special meeting at which the rebuffed bidder would put forward its most compelling offer, the board would make its most compelling case for remaining standalone, and the owners of the company would determine which narrative was more credible and compelling. The risk from which these bylaws "protect" shareholders, to put it bluntly, is the risk that they will be treated as owners, and asked to make serious and important decisions about the future of their company.

To date, the company has announced no intention to rescind the bylaws constraining shareholder's ability to exercise the right to call special meetings or act by written consent.

Is there material economic risk the special meeting would address?

Shareholders cannot, through this consent solicitation, take any direct action to accept or reject the Valeant offer. Valeant has publicly indicated it will not further increase its offer without engagement from the Allergan board. It has also indicated that it is unlikely to wait around for the next annual meeting, which could potentially be delayed as far as third quarter of 2015, given it had been pursuing a transaction with Allergan privately for nearly two years before it took its offer to shareholders publicly.

Every well-advised hostile bidder tries to signal such things as part of its public negotiation strategy, of course, just as every target of a hostile bid tries to impress on its shareholders that the miracle in the business plan is nearly here. Valeant, however, has shown itself a disciplined bidder in other public situations however—particularly in walking away from its offer for Cephalon in 2011—so there appears to be a reasonable risk that without a special meeting to put the issue directly into Allergan shareholders' hands, Valeant may in fact fold its offer.

How compelling that offer is, however, remains unclear this far in advance of a special meeting, precisely because neither bidder nor target has yet had to face an all-or-nothing shareholder vote on their plans for the future of Allergan. To choose between the Valeant offer and the next best alternative of remaining standalone company, shareholders first need both Valeant and Allergan to put forward their best, final, and most credible proposals.

The market value of the Valeant offer does remain substantially higher than the unaffected price of Allergan shares, however. Share price performance of other pharmaceutical firms (excluding those which have also had buyout-related news or speculation), which can be a reasonable proxy for how Allergan shares might have performed absent any public buyout offer, have been relatively flat since the Valeant offer was announced, suggesting that there might be significant downside risk to Allergan shareholders if Valeant withdraws its offer to pursue other opportunities.

Allergan has announced a number of new initia-

tives to improve business performance, which might reduce downside risk for investors if Valeant walks away, and has also raised its guidance. Many of the initiatives it has announced, moreover—reducing R&D and SG&A expense, looking at acquisitions—are strategies Valeant has used to enormous success over the tenure of its current CEO. This suggests both that there is merit in these business strategies, if Allergan can choose as wisely and execute as well and as boldly as Valeant —and also, perhaps, that Allergan's relentless criticism of the Valeant business model is rooted less in the conviction Valeant's model is dangerously flawed than in the conviction anything outside of the defensive perimeter should be scorched.

Is the call for a special meeting warranted?

Even simply reading through the Allergan bylaw regulating the exercise of the rights to call special meetings or act by written consent—but particularly after the additional if inadvertent evidence provided by the board's own external counsel in its memo on the topic—there is little credible reason to believe the Allergan board has in any meaningful way struck an appropriate balance between the ability of shareholders to exercise their governance rights and the risk some shareholder might somehow abuse those rights.

Neither is it clear, however, that some of these requirements—particularly the information requirements on "associates"—in any meaningful sense useful to the company in trying to weed out whatever it is the board most fears when shareholders want to use their outdoor voice. The term itself is defined so broadly that it includes "associates" who have no influence on investment decisions or strategies (the LLC which owns the vacation home of one fund's CEO comes to mind). Because it is so broadly defined, moreover—in a world of institutional investors with hundreds of billions in assets and countless individual investors, beneficiaries, managed accounts, etc.—it quickly daisy chains into a vast web of "associates" for whom the institutional shareholder trying to comply with the information request has no information rights to begin with.

The *reductio ad absurdum* is the situation in which the board, having approved this bylaw, is likely to soon find itself: overwhelmed with data it insists is critical to governing the company, but without any information rights to vet most of it.

Given the experience of many shareholders currently road-testing this same bylaw in the current consent solicitation, moreover, there seems increasingly little doubt that shareholders should seize the opportunity to do something about it, by supporting the call for a special meeting at which they will be able to eliminate them.

Having gone through the effort to call it, moreover, shareholders may also want to keep a weather eye on whether the board acts in the spirit of good governance to honor their request promptly, or instead engages in additional delaying tactics. Among these, it should be noted, is the possibility the board—having received a valid request from a sufficient number of shareholders who have undertaken the arduous work of complying with the bylaw—then insists on taking the full 120 days it has allotted itself to call the special meeting. As a benchmark, most companies—even Allergan, judging from its track record in calling annual meetings—find 30-45 days sufficient when the need arises.

If what transpires, once a valid request for a special meeting has been submitted, suggests an enduring and irreconcilable difference of opinion about what constitutes "good governance," shareholders may wish to further avail themselves of the opportunity, once a special meeting is finally called, to address the root cause of these governance concerns directly.

Given the substantial premium of the Valeant offer to the undisturbed price of Allergan shares, it may seem wise, as well, to allow the large strategic question —whether it is credible to believe remaining standalone will deliver higher value than selling—to also come to a head at the same meeting.

Major Shareholders—Allergan

		Ownership				Ownership
		Shares	% O/S	Filing	Filing Date	in Bidder
1	Pershing Square Capital Mgmt., L.P.	28,878,538	9.7%	13D	07/15/14	
2	Capital Research Global Investors	18,794,109	6.3%	13F	03/31/14	
3	Vanguard	14,976,461	5.0%	13F	03/31/14	
4	State Street	12,131,924	4.1%	13F	03/31/14	
5	Nomura Securities Co., Ltd.	11,969,171	4.0%	13F	03/31/14	
6	Blackrock	15,569,316	5.2%	13F	03/31/14	
7	Jennison Associates LLC	10,672,685	3.6%	13F	03/31/14	
8	State Farm Insurance Companies	10,526,400	3.6%	13F	03/31/14	
9	T. Rowe Price	7,592,851	2.6%	13F	03/31/14	4.2%
10	Delaware Investments	7,031,837	2.4%	13F	03/31/14	
11	AllianceBernstein	5,391,837	1.8%	13F	03/31/14	
12	Oppenheimer	4,514,114	1.5%	13F	03/31/14	
13	TIAA-CREF	4,352,049	1.5%	13F	03/31/14	
14	Edgewood Mgmt. LLC	3,938,793	1.3%	13F	03/31/14	
15	Fidelity	2,978,705	1.0%	13F	03/31/14	6.1%
16	Parnassus Investments	2,743,352	0.9%	13F	06/30/14	
17	Polen Capital Mgmt., LLC	2,648,664	0.9%	13F	03/31/14	
18	Capital World Investors	2,525,000	0.9%	13F	03/31/14	
19	Northern Trust Investments, Inc.	2,522,280	0.9%	13F	03/31/14	
20	Montag & Caldwell, LLC	2,379,819	0.8%	13F	06/30/14	
21	OrbiMed Advisors, LLC	2,270,000	0.8%	13F	03/31/14	
22	Franklin Advisers, Inc.	2,217,393	0.8%	13F	03/31/14	
23	UBS	2,128,098	0.7%	13F	03/31/14	
24	Geode Capital Mgmt., L.L.C.	2,124,533	0.7%	13F	03/31/14	
25	Norges Bank Investment Mgmt. (NBIM)	2,111,942	0.7%	13F	12/31/13	0.7%
		182,989,871	61.6%			

Source: Reuters Knowledge

Major Shareholders—Valeant

		Ownership				Ownership
		Shares	% O/S	Filing	Date	in Target
1	Ruane, Cunniff & Goldfarb, Inc.	34,217,366	10.3%	13F	03/31/14	
2	Fidelity	20,184,708	6.1%	13F	03/31/14	1.0%
3	ValueAct Capital Mgmt., L.P.	18,923,877	5.7%	13D	05/05/14	
4	T. Rowe Price	14,056,827	4.2%	13F	03/31/14	2.6%
5	Viking Global Investors LP	9,296,143	2.8%	13F	03/31/14	
6	Lone Pine Capital, L.L.C.	8,816,702	2.6%	13F	03/31/14	
7	TD Securities, Inc.	7,768,251	2.3%	13F	03/31/14	
8	Pearson, J Michael (CEO)	6,280,604	1.9%	Proxy	03/31/14	
9	JP Morgan Asset Mgmt.	6,069,203	1.8%	13F	03/31/14	0.5%
10	Brave Warrior Advisors, LLC	5,592,558	1.7%	13F	03/31/14	
11	BMO	7,918,653	2.4%	13F	03/31/14	
12	CIBC	4,417,373	1.3%	13F	03/31/14	
13	MFS Investment Mgmt.	4,399,673	1.3%	13F	03/31/14	
14	Caisse de Depot et Placement du Quebec	4,125,023	1.2%	13F	03/31/14	
15	Iridian Asset Mgmt. LLC	4,002,213	1.2%	13F	03/31/14	
16	Connor, Clark & Lunn Investment Mgmt. Ltd.	3,847,602	1.2%	13F	03/31/14	
17	Loomis, Sayles & Company, L.P.	3,251,485	1.0%	13F	03/31/14	
18	Barclays Capital Inc.	2,903,883	0.9%	13F	03/31/14	
19	Morgan Stanley	3,224,459	1.0%	13F	03/31/14	
20	Orbis Investment Mgmt. Ltd.	3,005,700	0.9%	13F	03/31/14	
21	Brahman Capital Corp.	2,913,051	0.9%	13F	03/31/14	
22	British Columbia Investment Mgmt. Corp.	2,906,151	0.9%	MF's	03/31/13	
23	ClearBridge Investments, LLC	2,848,160	0.9%	13F	03/31/14	
24	Davis Selected Advisers, L.P.	2,718,162	0.8%	13F	03/31/14	
25	Pyramis Global Advisors, LLC	2,703,725	0.8%	13F	03/31/14	
		186,391,552	55.9%			

Source: Reuters Knowledge

Background

Allergan, Inc. is a multi-specialty health care company focused on developing and commercializing pharmaceuticals, biologics, medical devices and over-the-counter products.

Pershing Square Capital Management, through one of its investment funds, is Allergan's largest shareholder at 9.7 percent of outstanding shares.

Valeant Pharmaceuticals is a Canadian-incorporated multinational specialty pharmaceutical firm.

Valeant first approached Allergan about a potential merger in 2012, but was rebuffed. In early 2014 Pershing Square and Valeant negotiated an agreement under which Pershing would effectively become a co-bidder for Allergan, and Valeant would invest in the fund Pershing Square would raise to buy a large "toehold" stake in Allergan, in preparation for a taking a revised buyout bid to the Allergan board and then, if necessary, to Allergan shareholders.

Pershing Square began rapidly accumulating Allergan shares in early spring, crossing the 5 percent ownership threshold (which triggers filing requirements under the SEC's rule 13D) on April 11. Over the next five trading days Allergan shares increased approximately 22 percent, as Pershing Square rapidly increased its buying program; when Pershing filed its initial 13D on April 21, it held 9.7 percent of outstanding shares. In other SEC filings at the time, Pershing disclosed the co-bidder arrangement and agreement with Valeant, and that it had agreed to take only Valeant equity, rather than cash, as its merger consideration in any transaction between the two pharmaceutical firms.

On April 22, 2014, Valeant announced an offer to buy Allergan for 0.83 Valeant shares and $48.30 in cash per Allergan share. Using Valeant's closing price of the previous day, the offer represented a market value of approximately $161 per Allergan share, a premium of 13.2 percent to Allergan's closing price of the prior day but 37.8 percent to Allergan's closing price 6 days earlier, on the day before Pershing Square crossed the 5 percent ownership threshold.

Allergan's board adopted a poison pill at a 10 percent threshold. On May 12, it formally rejected the Valeant offer. Two weeks later it aired its concerns about Valeant's business model and management team in a public investor presentation. After Valeant responded to these concerns in its own investor presentations and an electronic town hall, Allergan subsequently filed several additional critiques of Valeant in June and July. Valeant has continued to provide further explanation or additional response to these Allergan critiques.

On May 28, 2014, Valeant increased the cash component of its offer by $10, and added a Contingent Value Right (CVR) tied to performance of Allergan's pipeline drug DARPin. Two days later, in response to investor feedback, Valeant again raised the cash component of its offer by another $13.70, for a total consideration of $72.00 in cash plus 0.83 Valeant shares per Allergan share held. At Valeant's closing price the prior day, the market value of the offer was approximately $181, a premium of 27.4 percent to Allergan's closing price before any offer was announced, and 55.1 percent to Allergan's closing price the day before Pershing Square crossed the 5 percent threshold. The Allergan board rejected the revised offer on June 23.

Purpose of the Consent Solicitation

In response to the Allergan board's refusal to engage with Valeant on an offer Pershing Square feels is "compelling and certain," Pershing Square is soliciting support from at least 25 percent of shares to call a special meeting. If successful, at that special meeting Pershing would propose voting items which would:

1. Fix the special meeting provisions in the bylaws, which it believes are "unduly onerous and anti-shareholder," and
2. Remove and replace a number of directors such that the reconstructed board is more likely to "engage with Valeant."

As the bylaws specify that shareholders may not consider "similar items" on which they voted at another meeting within the previous year, it remains unclear whether shareholders would be able to elect replacements for any incumbents they choose to remove at this special meeting. Pershing Square believes section 223(c) of the Delaware General Corporation Law overrules the company's bylaws. Section 223(c) provides that when shareholders have removed more than half a board and holders of at least 10 percent of shares request it, the Delaware Court of Chancery may "summarily order an election … to fill any such vacancies or newly created directorships."

What is Required to Provide Consent

Ordinarily, shareholders may provide consent to such solicitations electronically, in the same manner in which they cast votes for a shareholder meeting. The Allergan bylaws, however, also require that each shareholder wishing to support the call for a special meeting must:

- Move shares into record name;
- Affirm its intent not to sell shares prior to the special meeting;
- Request that Cede & Co., the clearing house which holds shares in its name for banks, brokers and institutions, execute a meeting request on the shareholder's behalf, and provide Cede & Co. with a letter from the shareholder's DTC participant verifying its shareholdings;
- Answer an extensive written information request on matters ranging from whether the shareholder has dividend rights which may be separable from the common shares, to whether any shares are owned on margin (as well as the total margin indebtedness), to "any material relationship with the company, any affiliate of the company, any officer, director or employee of the company or any affiliate thereof, or any [of the more than 30 named] principal competitors."
- Provide similar information disclosure for "associates" of the shareholder (and associates of "any person or entity within" that shareholder), a broad term which explicitly includes spouses, children, trusts, corporations or other business entities.
- Provide two years of transactions history, including "any currently proposed transaction," which involve Allergan or its securities.

Given the complexity of complying with these bylaws, and the fact that the electronic proxy voting process would support only one of the many actions a consenting shareholder must complete, Pershing Square is not soliciting consents electronically. Instead, Pershing Square has established a web site (www.AdvancingAllergan.com) to provide shareholders with the requisite forms, and with assistance navigating the thicket of bylaw requirements the Allergan board has set in place. This site also provides a paper proxy card which consenting shareholders will return, in lieu of an electronic proxy card, as part of the entire submission.

What is Required to Withhold or Revoke Consent

Shareholders who do not wish to call a special meeting may simply take no action.

Shareholders who have previously complied with the bylaw requirements to provide consent can undo that action by returning management's consent revocation proxy card.

Shareholder Rationale for Calling a Special Meeting

Calling a special meeting is necessary, Pershing Square asserts, given the poor governance performance of this board. The risk to shareholders in leaving these actions unaddressed, however, extends far beyond this single public company: in particular, Pershing Square warns, if the bylaw restrictions through which this board has frustrated the ability of shareholders to exercise their rights are allowed to stand, such undue restraints "will be widely promoted by 'defense' firms and risk being widely adopted in Corporate America."

At Allergan's 2012 and 2013 annual meetings a majority of shares voted in support of shareholder proposals to add the rights to call special meetings and act by written consent. In implementing these shareholder directives Pershing Square points out, the board added bylaw restrictions—for which it did not seek shareholder approval—to "neuter" these rights. Shareholders attempting to call a special meeting, for example, must hold their shares through the date of the special meeting; they must transfer shares into record name, which "adds substantial logistical and compliance" complications for institutional shareholders; they must meet "unduly onerous disclosure requirements," with a duty to provide ongoing updates, which few companies require even of the shareholder initiating such a request for special meeting, let alone those merely supporting the request; each supporting shareholder must take the "highly unusual" action of requesting that Cede & Co., the clearing house which holds shares in its name for banks, brokers and institutions, execute a meeting request on its behalf, and provide Cede & Co. with a letter from the shareholder's DTC participant verifying its holdings, rather than relying on the longstanding and less cumbersome omnibus proxy process.

Special meetings may not consider "similar items" covered at a meeting in the previous year, nor be called in the period from 90 days before the anniversary of the previous annual meeting through the adjournment of the next annual meeting. Having received a completed request from a sufficient number of shares, the board determines "in [its] sole discretion whether meeting requests are compliant," and even then it can delay the special meeting for up to an additional 120 days. Shareholders who meet the extensive procedural requirements, and avoid even immaterial "foot faults" for which the board can apparently reject the request, are left with a small window of opportunity in the calendar year during which to actually hold the special meeting they have called. Similar bylaw provisions afflict the "right" to act by written consent.

The board adopted a poison pill in April, in response to Valeant's offer. Its use of the ambiguity in that pill "to discourage the solicitation of proxies" in this consent solicitation, Pershing Square emphasizes, signals its willingness to further obstruct shareholders' efforts to exercise their governance rights. Only after Pershing Square, having received no direct response to its clarifying questions on whether a solicitation might trigger the pill, sued to resolve the issue "did management confirm that the solicitation of proxies and certain related activities" - principally helping other shareholders understand the thicket of information requirements required of them—"would not trigger the pill."

The board's entire rationale for opposing the special meeting—the distraction and financial cost of holding the meeting—would go away, Pershing emphasizes, if the board would simply engage with Valeant. To date, however, it has "failed to do any reasonable investigation of the Valeant transaction," even refusing to allow its advisors to meet with Valeant to address the board's stated concerns about Valeant's business model or financial reporting. This raises the question, Pershing Square emphasizes, of whether the directors are acting with due care.

Valeant's offer, Pershing Square points out, represents a premium of more than 50 percent to Allergan's unaffected trading price, one of the largest premiums of any pharmaceutical transaction greater than $15 billion in the past decade (and significantly higher than the median of 34 percent). The offer implies an EV/Last Twelve Months EBITDA multiple of 23x, also among the highest of those precedent transactions and also significantly higher than the median of 16.8x. To the extent Allergan's actions have raised investor doubts about whether the transaction will occur, moreover, the market price of Valeant shares may not adequately reflect the full value of the offer. On a "look through" basis which includes synergies, Pershing argues, the offer may be worth more than $223 per share—or a 91 percent premium to the unaffected price and an EV/LTM EBITDA multiple of more than 30x.

In the face of a board unwilling to engage even on an offer more compelling than any other large pharmaceutical transaction of the last decade, Pershing Square concludes, a special meeting is necessary both to rectify the bylaw provisions that disenfranchise shareholders, and to "create a path to completion of a compelling offer."

Management's Rationale for Opposing the Special Meeting Request

In its consent revocation proxy statement, the company asserts that calling a special meeting is premature and unnecessary, as the directors Pershing Square would seek to remove were just elected by shareholders three months earlier at the 2014 annual meeting. In unanimously rejecting the Valeant offer, the company emphasizes in several investor presentations, the board acted out of conviction that "Allergan stockholders have nothing to 'gain' by merging with Valeant," particularly since Allergan's management and board "are committed to delivering the highest value for Allergan shareholders."

As Pershing Square is "a co-bidder in an unsolicited proposal to acquire Allergan that the board has concluded is grossly inadequate," the company contends, "the interests of Pershing Square are not aligned with the interests of all [Allergan] stockholders." The board believes that Pershing Square and Valeant, instead, are attempting to avoid paying full value for Allergan. Calling a special meeting now would therefore "have significant and important consequences for the company," particularly the diversion of significant resources, including management time and attention, away from execution on the strategic plan and into solicitation efforts for the special meeting. A more prudent approach, the board asserts, would be "to focus on extending [Allergan's] track record of substantial growth that the board and management are confident will create significantly more value for stockholders" than the unsolicited buyout offer.

The company's consent revocation proxy statement does not directly address Pershing Square's contention that the bylaws constraining the right to call a special meeting are unnecessary and onerous, or in need of revision.

Responding to direct questions from a research meeting with ISS, however, the company subsequently filed a July 26, 2014 memo from its legal advisors explaining "the process the Corporate Governance and Compliance Committee followed [in developing the bylaw] and provid[ing] precedents that other public companies currently have in place." In a cover letter to that memo, the Lead Independent Director emphasized these bylaw provisions "were important to avoid frivolous or special interest activists from gaming the system to the disadvantage of all other stockholders." The Committee's objective, the Lead Director underscored, "was not to thwart shareholder democracy but to ensure that special meetings of stockholders were called to deal with important, broad-based stockholder concerns that did not need to wait until the annual meeting."

The board explicitly remarks in its consent revocation proxy statement that it reserves the right "to require full compliance with the provisions set forth in our Charter, Bylaws and applicable law... with respect to any special meeting sought to be called by Pershing Square or any other stockholders."

ISS Analysis

Are Pershing Square's economic incentives appropriately aligned with those of other investors?

Allergan's soliciting materials assert that the interests of Pershing Square, which is leading this consent solicitation, are not aligned with those of other shareholders. This assertion merits an assessment from other shareholders.

As the basis for its assertion, Allergan points to an agreement Pershing Square made with Valeant in late May to allow Valeant to further increase its offer on May 30. In that agreement, Pershing Square committed to take a lower exchange ratio than the 0.83 offered to other shareholders, and also to take all of its consideration in shares rather than cash. This had the effect of allowing Valeant to increase the per-share value of its offer to all other shareholders without increasing the aggregate amount it would pay. Effectively, Pershing Square agreed to transfer some of the merger consideration it would receive, should a transaction take place on the May 30 terms, to all other shareholders, in order to increase the attractiveness of the offer.

In Allergan's soliciting materials this arrangement has been wrenched into the blithe assertion that Pershing Square would somehow "benefit if Valeant pays less for Allergan." In fact, however, the agreement only holds if any transaction occurs on the same terms Valeant announced May 30; any increase in offer value from there implies an increase in the consideration Pershing Square would receive, unless Pershing Square again offered to take a lower per-share consideration than other shareholders. Valeant, as a strategic acquirer, has a vested interest in not overpaying; Pershing Square, as the largest shareholder in the target (and which holds no shares in the acquirer), does not appear to have any incentive to see the lowest price paid.

If it is untrue that Pershing Square's incentives run counter to those of other shareholders, however, it remains prudent for each shareholder to consider the arguments for and against calling a special meeting on their own merits, regardless of the conclusions one large shareholder has reached.

In particular, shareholders should consider whether calling a special meeting now would allow them an opportunity they would not otherwise have to address significant issues at the company, regardless of whether they ultimately agree that the company should be sold.

Do governance issues suggest a special meeting is necessary?

In presentations to investors the board has asserted it has demonstrated a commitment to "good governance," noting that shareholders approved by overwhelming margins the board's binding proposals to allow for the rights to call special meetings (84.5% of votes cast at the 2013 annual meeting) and to act by written consent (80.4% of votes cast at the 2014 annual meeting). In an engagement meeting with ISS, the company asserted in particular that it has not heard any discontent from shareholders about the procedural requirements to call a special meeting.

Shareholders were only asked to vote, however, on the article amendment which granted these rights, and not on the thicket of procedural constraints imposed by the bylaws the board also adopted. The high shareholder support for the article amendments likely reflected shareholder belief that getting even a highly restricted right was preferable to not having it at all. The high withhold votes at the 2014 annual meeting against the Lead Independent Director (33.4 percent) and other members of the Governance Committee (11.7-11.9 percent) which oversaw development of the bylaw provisions, by contrast, appear to reflect deep dissatisfaction with the dichotomy between the mandate shareholders provided and the manner in which the board, in implementing that mandate, effectively undercut it.

Asked in an engagement meeting how the bylaw the board implemented was an appropriate response to the mandate shareholders had provided, representatives of the company asserted the board had tried to strike a balance between corporate democracy and the risk these rights might be misused. Asked how, specifically, requiring that all shareholders supporting a call for a special meeting provide two years of trading history helped strike that balance, representatives of the company averred that it was necessary to have "a process" for orderly exercise of these governance rights. Asked, instead, how requiring such extensive disclose every relationship between any "associate" of the shareholder—a term which apparently extends to the LLC through which the CEO of one shareholder owns a vacation home—and the company, its "associates," and its numerous competitors helped strike that balance, repre-

sentatives of the company reiterated that the board believed in preventing potential misuse of these governance rights. Asked, further, how requiring each supporting shareholder transfer shares into record name and file an individual request for a meeting through Cede & Co, rather than use the omnibus proxy process which is customary in the industry (and apparently presents no issues for the company on any other proposal) helped strike that balance, representatives of the company averred that they were not familiar with every detail of the bylaw governing the calling of special meetings.

Asked once again, in summary, to reconcile how the extensive bylaw constraints the board had placed on the right to call special meetings was an appropriate response to a shareholder mandate, rather than an attempt to frustrate shareholders' exercise of their governance rights, the lead independent director offered that the board had been informed by its advisors that such bylaw constraints were common at other companies. Asked to provide the names of ten such companies, the company responded several days later with a fresh seven-page memo from its external counsel listing twenty companies with at least one similar provision in their bylaws, and laying out the Allergan board's rationale for each of the major procedural requirements it had implemented.

Bylaws Constraining Right to Call Special Meetings

		Constraint					
	SP500 Rank	Record Holder Only	Must Hold to Meeting	Sales Reduce Support	Add'l Info Requests	Blackout Periods	"No Similar Items"
American Express Co.	90	●		●		●	
Amerisourcebergen Corporation	32	●		●		●	
Apache Corporation	167	●	●	●			
Coca-Cola Company	57			●		●	
eBay Inc.	196	●		●	●	●	
Ideal Power Inc.	microcap	●	●	●		●	●
JPMorgan Chase & Co.	18	●		●		●	
McDonald's Corporation	111	●	●				●
Medifast Inc.	microcap	●	●	●	●	●	●
NASDAQ OMX Group,	midcap	●		●	●	●	
Northrop Grumman	120	●			●	●	●
Quest Diagnostics Inc.	341	●	●	●			
Radioshack Corporation	microcap	●	●				
Ross Stores Inc.	278		●	●		●	
The Allstate Corporation	92	●		●		●	
The Goldman Sachs Group,	68	●		●		●	
United Continental	79	●		●	●	●	
Waste Management	200	●		●		●	
Western Union Company	445	●		●		●	
Yahoo! Inc.	494	●	●	●		●	
Mid or Microcap Companies	4	4	3	3	2	3	2
S&P 500 Companies	16	14	5	14	3	13	2
All 20 Comparators	20	18	8	17	5	16	4

Source: Allergan filing

As a response to a request for ten names, the memo (subsequently filed with the SEC and available for all shareholders to review), is an impressively weighty thing, with no fewer than 16 footnotes substantiating matters of Delaware corporate law and correlating each procedural requirement with the appendix of twenty firms purported to impose substantially similar procedural hurdles on their shareholders who wish to call special meetings.

As a response to the deeper question of why Allergan's bylaw constraints were an appropriate response to the shareholder mandate to provide certain governance rights, by contrast, it appears to have been an exercise in concealing what was never worth finding: the Allergan bylaws are far more restrictive than any of the comparator companies the board apparently reviewed, with no discernable advantage for Allergan shareholders.

Less than half of the comparator companies, for example, have more than three of the constraints—and the constraints they do impose are overwhelmingly the least onerous for shareholders wishing to support the call for a special meeting: establishing blackout periods during which a special meeting may not be called, for example, or providing that shares sold by a supporting shareholder will be netted out of the total number of shares consenting to call the meeting, or in many cases requiring that the share-

holder spearheading the call for special meeting hold shares in record name. The list includes 16 S&P 500 companies, which might seem appropriate comparators—but also three microcaps and a midcap, apparently included to bolster the count of companies which have more onerous provisions. The three microcaps alone account for nearly half of the instances of shareblocking (3 of 8), additional information requirements (2 of 5), and "no similar items" (2 of 4) provisions. Only two of the twenty companies have more than 4 of these restrictions—and both of them are microcaps.

In calls with investors considering whether to support the request for special meeting, ISS heard repeatedly that the additional procedural and information requirements laid out by the Allergan bylaws imposed a significant burden, and the opportunity to eliminate them at this special meeting was increasingly becoming a meaningful reason to persist in calling the special meeting.

It is also a reason the board itself could have eliminated—and perhaps traded up to some good will from the shareholders it represents—by simply rescinding the bylaw restrictions.

Tactically, in the face of an unsolicited offer at a more than 50 percent premium to the unaffected trading price, such a move might seem ill-advised. But that tactical advice itself epitomizes "short term perspective." From a broader and more enduring governance perspective—a perspective, one might argue, distinctly appropriate for a board of directors, if not necessarily its advisors—enabling the owners of the company real access to the governance rights granted them in the articles of incorporation would clearly be the appropriate response.

One might object, reasonably enough, that good governance also involves asking what unintended risks or consequences shareholders might face if these unusual and unnecessary constraints on the right to call special meetings were eliminated. The answer appears to be that, at this company and at this moment in time, shareholders would likely be faced with a special meeting at which the rebuffed bidder would put forward its most compelling offer, the board would make its most compelling case for remaining standalone, and the owners of the company would determine which narrative was more credible and compelling. The risk from which these bylaws "protect" shareholders, to put it bluntly, is the risk that they will be treated as owners, and asked to make serious and important decisions about the future of their company.

To date, the company has announced no intention to rescind the bylaws constraining shareholder's ability to exercise the right to call special meetings or act by written consent.

Is there material economic risk the special meeting would to address?

Shareholders cannot, through this consent solicitation, take any direct action to accept or reject the Valeant offer. Valeant has publicly indicated it will not further increase its offer without engagement from the Allergan board. It has also indicated that it is unlikely to wait around for the next annual meeting, which could potentially be delayed as far as third quarter of 2015, given it had been pursuing a transaction with Allergan privately for nearly two years before it took its offer to shareholders publicly.

Every well-advised hostile bidder tries to signal such things as part of its public negotiation strategy, of course, just as every target of a hostile bid tries to impress on its shareholders that the miracle in the business plan is nearly here. Valeant, however, has shown itself a disciplined bidder in other public situations however—particularly in walking away from its offer for Cephalon in 2011—so there appears to be a reasonable risk that without a special meeting to put the issue directly into Allergan shareholders' hands, Valeant may in fact fold its offer.

How compelling that offer is, however, remains unclear this far in advance of a special meeting, precisely because neither bidder nor target has yet had to face a come-to-Jesus shareholder vote on their plans for the future of Allergan. To choose between the Valeant offer and the next best alternative of remaining standalone company, shareholders first need both Valeant and Allergan to put forward their best, final, and most credible proposals.

The market value of the Valeant offer does remain substantially higher than the unaffected price of Allergan shares, however. Share price performance of other pharmaceutical firms (excluding those which have also had buyout-related news or speculation), which can be a reasonable proxy for how Allergan shares might have performed absent any public buyout offer, have been relatively flat since the Valeant offer was announced, suggesting that there

might be significant downside risk to Allergan shareholders if Valeant withdraws its offer to pursue other opportunities.

Allergan has announced a number of new initiatives to improve business performance, which might reduce downside risk for investors if Valeant walks away, and has also raised its guidance. Many of the initiatives it has announced, moreover—reducing R&D and SG&A expense, looking at acquisitions—are strategies Valeant has used to enormous success over the tenure of its current CEO. This suggests both that there is merit in these business strategies, if Allergan can choose as wisely and execute as well and as boldly as Valeant —and also, perhaps, that Allergan's relentless criticism of the Valeant business model is rooted less in the conviction Valeant's model is dangerously flawed than in the conviction anything outside of the defensive perimeter should be scorched.

Is the call for a special meeting warranted?

Even simply reading through the Allergan bylaw regulating the exercise of the rights to call special meetings or act by written consent—but particularly after the additional if inadvertent evidence provided by the board's own external counsel in its memo on the topic—there is little credible reason to believe the Allergan board has in any meaningful way struck an appropriate balance between the ability of shareholders to exercise their governance rights and the risk some shareholder might somehow abuse those rights.

Neither is it clear, however, that some of these requirements—particularly the information requirements on "associates"—in any meaningful sense useful to the company in trying to weed out whatever it is the board most fears when shareholders want to use their outdoor voice. The term itself is defined so broadly that it includes "associates" who have no influence on investment decisions or strategies (the LLC which owns the vacation home of one fund's CEO comes to mind). Because it is so broadly defined, moreover—in a world of institutional investors with hundreds of billions in assets and countless individual investors, beneficiaries, managed accounts, etc.—it quickly daisy chains into a vast web of "associates" for whom the institutional shareholder trying to comply with the information request has no information rights to begin with.

The *reductio ad absurdum* is the situation in which the board, having approved this bylaw, is likely to soon find itself: overwhelmed with data it insists is critical to governing the company, but without any information rights to vet most of it.

Given the experience of many shareholders currently road-testing this same bylaw in the current consent solicitation, moreover, there seems increasingly little doubt that shareholders should seize the opportunity to do something about it, by supporting the call for a special meeting at which they will be able to eliminate them.

Having gone through the effort to call it, moreover, shareholders may also want to keep a weather eye on whether the board acts in the spirit of good governance to honor their request promptly, or instead engages in additional delaying tactics. Among these, it should be noted, is the possibility the board—having received a valid request from a sufficient number of shareholders who have undertaken the arduous work of complying with the bylaw—then insists on taking the full 120 days it has allotted itself to call the special meeting. As a benchmark, most companies—even Allergan, judging from its track record in calling annual meetings—find 30-45 days sufficient when the need arises.

If what transpires, once a valid request for a special meeting has been submitted, suggests an enduring and irreconcilable difference of opinion about what constitutes "good governance," shareholders may wish to further avail themselves of the opportunity, once a special meeting is finally called, to address the root cause of these governance concerns directly.

Given the substantial premium of the Valeant offer to the undisturbed price of Allergan shares, it may seem wise, as well, to allow the large strategic question —whether it is credible to believe remaining standalone will deliver higher value than selling—to also come to a head at the same meeting.

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