

**Statement by David E.I. Pyott**

**Permanent Subcommittee on Investigations**

**July 30, 2015**

Thank you, Chairman Portman and Ranking Member McCaskill.

My name is David Pyott, and I am the former Chairman & CEO of Allergan. Until it was acquired by Actavis in March 2015, Allergan was a great American pharmaceutical company—entrepreneurial, science-driven, and customer focused. It boasted many market-leading innovative products, including eyecare medications, medical aesthetics, and Botox (which had therapeutic purposes as well as its famous cosmetic indications). In our product markets, we were typically number 1 or number 2 globally.

Allergan had only three CEOs in its 65-year history, and I was privileged to have that job for 17 years, from 1998 until 2015. During that time, Allergan experienced tremendous growth, going from \$600 million in sales in 1997 to more than \$7 billion in 2014. Sales growth led to valuation growth: When I first joined Allergan, its market capitalization was \$2 billion; by early 2014, it was \$37 billion. We also added more than 6,000 employees to our workforce over that period—from 4,000 in 1997 to 10,500 at end of 2013. More than 60% of our sales were domestic, but Allergan had considerable amount of international sales revenue, through various foreign operating subsidiaries.

Our growth was principally organic; acquisitions contributed only about \$450 million of our sales revenue. We grew through extensive investment in research and development, leading to new products. Allergan's R&D investments increased from less than \$100 million to over \$1 billion in 2014, leading to a steady stream of regulatory approvals from the FDA and foreign regulatory agencies.

In 2014, Allergan's future outlook was bright: We projected double-digit revenue growth and mid-teens increases in earnings per share for the period from 2014–2018, even after continued double digit increases in R&D investment.

But ultimately, those very qualities—sustained growth, robust research and development, a long-term focus, and international sales—made Allergan a very attractive target for acquisition. And in the end, that almost inevitably meant acquisition by a foreign company.

The reality is that the U.S. Tax Code, with its high corporate rate and outlier worldwide system of taxation, puts American companies like Allergan at a tremendous disadvantage. Just before our acquisition, Allergan's effective tax rate was approximately 26%—a rate that would have been even higher if we had repatriated more non-U.S. earnings. Before the acquisition, we had almost \$4 billion in cash, most of which was located offshore and, under U.S. tax law, could not be repatriated without a tax

penalty. That stands in contrast with our competitors based in other industrialized nations, most of which permit their companies to repatriate overseas earnings without incurring additional tax.

These tax advantages are worth literally billions—billions that a foreign acquirer has access to—essentially for free—but American companies do not. Unsurprisingly they use those billions to buy up American companies that cannot compete with the tax savings offered by the vast majority of other OECD nations. But once the American company is bought, its new foreign owner has every incentive to strip out its intellectual property and take those patents abroad, and leave its new American subsidiary loaded up with debt. The result is a loss to the Treasury, to jobs and wages, and to the incentive to build innovative, long-term-focused companies in the United States in the first place.

### **The 2014-2015 battle for control of Allergan**

Over the course of 8 months in 2014, a battle raged for corporate control of Allergan. We were targeted for takeover by Valeant—a Canadian firm that has had an enormous appetite for acquiring pharmaceutical companies, and has stated no interest in growing through innovation and R&D of its own. But Valeant had just completed an \$8 billion acquisition of Bausch & Lomb in 2013, and was too weak and laden with debt from that transaction to contemplate buying Allergan on its own. So Valeant entered into a partnership with Pershing Square, a firm run by activist investor Bill Ackman, to go after Allergan together. It was the first-ever partnership of its type. In the February to April 2014 timeframe, using stock purchases and then options and derivatives, Pershing Square was able to accumulate about 9.7% of Allergan’s outstanding shares without making any public announcement of its actions.

On April 22, Valeant submitted a bid to buy Allergan for \$47 billion, an increase from the \$37 billion valuation when Pershing Square initiated its first purchases of stock, a premium of \$12 billion, or 25%.<sup>1</sup> Such a premium was enabled by the enormous tax savings available to Valeant as a foreign company, allied with their rapacious cost cutting plan. Valeant, as a Canada-based enterprise with operations in Bermuda, Ireland, and Luxembourg, had an effective tax rate of about 3%. And when it made its case for buying Allergan to Wall Street and our investors, Valeant claimed it could reduce Allergan’s 26% effective tax rate to 9%—a difference of 17% or \$500 million. Applying a price earnings multiple to approximately \$500 million in tax savings, this gave Valeant and Pershing Square roughly a \$9 billion valuation advantage. In simple terms, Allergan was worth \$9 billion more - just by being moved to foreign control than it was worth as an American company.

Nevertheless, I and the Allergan Board did not think the Valeant transaction was in the best interest of Allergan’s shareholders. Even though it could offer a substantial premium, owing to its tax savings, Valeant’s long-term plans for Allergan did not seem to the Board and I designed to maximize the value of the company over the long term. Valeant and Pershing Square made clear they intended to strip Allergan's operations.

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<sup>1</sup> Curiously, the next day, Pershing Square posted a billion dollars in paper profit – something I hope will lead the Securities & Exchange Commission to investigate the novel structure of their transaction to determine whether Valeant and Pershing Square violated insider trading laws and other securities regulations.

Valeant's acquisition proposal was to slash Allergan's investments in R&D from more than \$1 billion to about \$200 million—along with our market-building investments in Allergan’s salesforce and promotion and educational programs for physicians. Consequently draconian reductions were planned not only for our R&D department but also for our selling, marketing and administrative staffs. Overall, Valeant’s final plan, filed on the very day of the announcement of the acquisition, proposed a reduction in operating expenses of over 40%.

In my view, Valeant’s strategy was a clear example of “asset stripping” for short-term profit. That strategy is not sustainable in the long-term; more companies must be continuously acquired in a roll-up before the project collapses. Under the terms of the initial bid for Allergan, Valeant planned to load up Allergan up with more than \$22 billion in new debt; taking the debt load of the combined company, Allergan and Valeant, to more than \$50 billion.

As the proposed acquisition undervalued the company and gutted our operations, we vigorously resisted the hostile bid as we ramped up our performance and evaluated many strategic alternatives. The battle for control lasted 8 months, and although the Board was put under enormous pressure in the media and by event driven investors, the Board never buckled. We were convinced that this was not a value-creating deal. Beyond just selling to the highest bidder, a major consideration for the Allergan Board was any potential acquirer’s commitment to ongoing investments in R&D as well as in sales and marketing infrastructure both in the US and around the world. Ultimately, the Board decided to seek out a “white knight” with the intent to create higher value for our shareholders than the Valeant offer which was raised three times and signaled that a fourth raise was in prospect.

But in our evaluation of potential white knight bidders, it was clear to me that only a foreign-domiciled company could be in a position to outbid Valeant whilst still creating value for their own stockholders. American firms could not match Valeant’s favorable tax position. The tax-planning techniques available to foreign acquirers are too lucrative: (1) a debt push down on the US entities by tax-advantaged foreign entities that are domiciled abroad in low tax jurisdictions, and (2) migration of intellectual property to low-tax jurisdictions, even despite a penalty paid to the IRS shortly after the acquisition. Valeant contemplated both.

Ultimately, we announced in November 2014 a bid for Allergan by an Irish pharmaceutical company called Actavis for \$66 billion. Similar to Valeant, Actavis could immediately reduce Allergan’s effective tax rate—from 26% to 15%. As the figures below illustrate, both Valeant and Actavis were able to offer substantial acquisition premiums above Allergan’s \$37 billion valuation in February 2014.

First stock purchases by Pershing Square — February 2014	\$37 billion
First Valeant Bid — April 2014	\$47 billion
Highest formal bid by Valeant — October 2014	\$55 billion
Actavis bid — November 2014	\$66 billion

Actavis offer at close — March 2015	\$71 billion <sup>2</sup>
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But for the systematic disadvantages of the U.S. tax code, however, Allergan would likely not have been sold. The return created by the billions of dollars available to shareholders just for selling to a foreign firm, however, can be irresistible. I liken it to playing on a sports field physically tilted 20 degrees against the home team.

### **Implications of the Allergan takeover**

I am proud that we were able to salvage most - and what we could of - a great American company. I am especially pleased to report, for example, that in 2014—in the midst of a battle for our existence—Allergan had the best operating year in its 65 year history: Sales in local currency increased by 16% from \$6 billion in 2013 to over \$7 billion in 2014.

Actavis is committed to maintaining the best of Allergan in the new combined company, and it is a point of pride for me that Actavis adopted Allergan as its new corporate name in June 2015. The new combined company will dedicate \$1.8 billion to R&D, a substantial increase from the \$1 billion expended by legacy Allergan.

But it is not all good news. Actavis was up front and clear with employees and other stakeholders that both sales synergies, and more importantly cost synergies, have to be found to pay for the acquisition premium to acquire Allergan. Those synergies must total about \$1.8 billion, and will entail a reduction of about 11% of operating expenses from across both firms. As for jobs, although I am no longer with the company, I would estimate that about 1,500 jobs will be eliminated from the legacy Allergan side, most of them in California.

### **Conclusion**

Reflecting back on the fight for control of Allergan, I am convinced that we would have remained an independent, American company had it not been for the disadvantages caused by our uncompetitive U.S. corporate tax system. The implications for the rest of the pharmaceutical and biotech industry are clear. Unless Congress acts, the price of inaction will be the continued loss of the most innovative companies in our economy. My view is that this will extend to other firms across the entire healthcare industry as well as other industries.

The primary problem is the simple one: We have the highest corporate tax rate in the world, and we need to reduce it to be in line with other leading industrial economies. We must also transition to a modern territorial tax system that allows U.S. businesses to expand abroad while creating jobs at home.

The penalty on American companies for the repatriation of foreign earnings causes economic problems. The location of cash should not distort the decision of where to invest it. As it now stands, the “lock

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<sup>2</sup> Due to the rise in Actavis stock price post announcement. About 60% of payment was in Actavis stock, 40% in cash.

out” of foreign earnings incents U.S. businesses to create jobs abroad, by reinvesting un-repatriated earnings, rather than bringing those earnings home to invest domestically.

I applaud the Subcommittee for focusing on these important issues, and thank you for the opportunity to testify about my experience.