



Poison Pills and the Weapons To Defend a Hostile Takeover A Talk with Professor John Morley

I. Hostile Takeovers

- A. In a friendly takeover, the target company agrees to a merger or acquisition by the acquirer. Typically, a public offer is made, and the target firm approves buyout terms.
- B. In the 1980s, hostile takeovers of U.S. firms peaked at about 14 percent. In 2014, about 7 percent of global deals were hostile, a rate higher than in recent past.¹
- C. Hostile takeovers occur when an acquirer takes over the target company without the consent from the board or the management of the target company. They typically occur via a tender offer or in a proxy fight.
 - 1. A proxy contest involves shareholders voting together to replace company management or gain support for acquisition.
 - 2. A hostile takeover via a tender offer involves the acquiring company offering to buy shares of the target for a premium directly from the shareholders.
- D. Maryland Control Share Acquisition Act
 - 1. Also known as the “Control Share Act,” the Act is example of state laws that make it difficult more difficult for acquirers to affect hostile takeovers.
 - 2. It provides that control shares of a corporation acquired via a control share acquisition have no voting rights except to the extent approved by 2/3 of disinterested votes.²

II. Defenses

- A. Poison pill
 - 1. The poison pill or the shareholders rights plans permit the board of directors to issue a form of preferred stock, giving the existing stock holders the right to purchase stock at a discounted price upon the acquisition of a certain number of shares by the acquirer.
 - 2. If executed, the result is that the hostile bidder’s toehold stake is significantly diluted.
 - 3. Over half the states explicitly allow poison pills by statute. Other states including Delaware recognize them by judicial decisions. The Delaware Supreme Court upheld poison pills as a valid instrument of takeover defense in *Moran v. Household International, Inc.* 500 A.2d 1346 (Del. 1985).

¹ David Gelles, *Hostile Takeover Bids for Big Firms Across Industries Make a Comeback*, THE NEW YORK TIMES, July 12, 2014.

² MD. Code Ann., Corps. & Ass’ns § 3-701(a)(1)



4. The poison pill may be circumvented by negotiating with the board to voluntarily redeem the poison pill or gaining control of the board via a proxy fight prior to triggering the defense.
- B. Staggered or classified board
1. A staggered board is when only a part of the board is up for election in a given year. A staggered board is specified in the articles of incorporation or the bylaws. Most major public companies in the U.S. have staggered boards.
 - a. N.Y. BCL § 704 provides that the certificate of incorporation or bylaws may specify that directors be divided into two to four classes and the terms for each class expire at different annual meetings.
 2. A staggered board may make it more difficult for an acquirer to gain control of the board. For an acquirer to gain control of a staggered board, it must win multiple proxy fights over a period of time, dragging out the takeover process.
 3. When combined with the poison pill, it can be an effective deterrent to a hostile takeover.
- C. Golden parachute
1. Golden parachute or change of control agreements provide for large payments to executives or board of the target company in the event of a change in effective control of a corporation or ownership of a substantial portions of the corporation's assets.
 2. Golden parachutes are agreements between the executives and the company, not found in corporation documents. Generally, the board decides and votes on the agreements. Some states may require shareholder approval.
 3. While one purpose of golden parachute provisions is to compensate the executive for loss of her job, it also may be a deterrent to takeovers by increasing the cost for the acquirer. However, golden parachutes serve as a deterrent inasmuch as the amount is significant. In many cases, the cost to the acquirer is as little as 1% of the total cost of takeover.
- D. Greenmail
1. Greenmail refers to the target company buying back its shares from the potential acquirer at a premium in exchange for delaying or abandoning a takeover.
 2. Several states have anti-greenmail statutes, including New York.
 3. New York BCL prohibits a corporation from repurchasing more than 10% of its stock from a shareholder for more than market value without approval from its board and disinterested shareholders.
- E. Pac-man
1. Pac-man defense involves the target company turning around and making a bid for the acquirer company.
 2. It is an aggressive defense strategy but is less oft used than some of the other defenses.
- F. Macaroni
1. A macaroni strategy involves the target company issuing a large number of bonds to be redeemed at an excessively higher value in the event of a



takeover. The swelling price of the bonds upon acquisition will hurt the shareholders and may make the takeover prohibitively costly to the acquirer.

2. Macaroni tactics are typically established in the bylaws.

III. Takeover Defenses - Effective or Necessary?

A. Arguments in Favor of Takeover Defenses

1. Defenses contribute to healthy corporate governance. When a company builds defenses against hostile takeovers into its bylaws, its board is in a strong bargaining position that may help deter an acquirer from undervaluing payout on shares.
2. Defenses help prevent mass layoffs due to a merger.
3. Defenses are tools that help companies continue to operate stably

B. Arguments Against Takeover Defenses

1. The people who are willing to pay most for a company's shares ought to be able to control that company. Allowing companies to be managed by these individuals will create the greatest amount of value.
2. A loosely regulated market for hostile takeovers inherently holds corporate management accountable.