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The Poison Pill as a Corporate Defensive Strategy

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Mergers and acquisitions are processes in which two or more companies become consolidated into a single entity for the purpose of increasing reach or gaining larger market shares. While these transactions can develop in various ways, many M&A attempts can be hostile, unfriendly, and against the wishes of the target company.

Fortunately, several defense strategies could be employed to shield the corporation against hostile takeovers that often arise unexpectedly and catch the management of the target company by surprise. These include: the Crown Jewels Defense, the Golden Parachute, and the Poison Pill strategy.

The Poison Pill defense, more formally known as “Shareholder Rights Plans”, consists of making the stocks of the target company less attractive by allowing current shareholders of the target company to purchase new shares at a discount. This will result in increasing the number of shares the acquirer company needs to buy in order to obtain a controlling interest, and therefore making the target company’s equity less attractive to potential acquirors. The goal of the poison pill is to change the hostile bidder’s mind and to make the acquisition seem undesirable, thus abandoning the takeover attempt.

While the term “poison pill” historically originated from a method used by captured spies to avoid revealing information to their enemies; it was first implemented in the corporate world by lawyer Martin Lipton, in the year 1982. At the time, Mr. Lipton was representing a large corporate client, General American Oil, who faced a hostile takeover attempt from another corporation. In order to put off the potential acquirer, and make the acquisition far less attractive, Lipton created the poison pill strategy.

For the purpose of better understanding the poison pill defense, and the importance of its implementation in light of today’s economic difficulties and their impact on corporations, we will first discuss the types of strategies and consequences of their adoption in part 1 of the study, then proceed to analyze recent real-world examples of the poison pill strategy’s implementation in part 2.

Part 1: Strategies and Impact of the Poison Pill defense

Hostile takeover activities often correspond with periods of extreme market instability. In today's business environment, a significant increase in the adoption of poison pill strategies is expected, as companies are confronting a sharp decline in stock prices following the COVID-19 pandemic and major economic challenges. That being the case, companies concerned about their vulnerability to a hostile takeover attempt or, impacted by significant stock price declines should proactively consider preparing rights plan materials, reviewing this plan with the board, and either adopting or putting the poison pill defense "on the shelf."

Poison Pill strategies can take the form of flip-in, flip-over, and the "Golden Handcuffs" technique.

- **Flip-in** poison pills are relatively common. According to this strategy, a company allows current shareholders to purchase additional shares at a discount as a way to dilute the share ownership of the target company, thereby making the acquisition of a controlling interest in the company more difficult and expensive.
- A **"flip-over"** poison pill on the other hand is the opposite of a flip-in. A flip-over plan allows stockholders of the target company to purchase shares of the acquiring company at steep discounts, which results in the dilution of the value of shares corresponding to the acquiror's company. If the value is diluted substantially enough, the acquiror may become concerned at his post-acquisition company's value.
- The **"Golden Handcuffs"** technique aims to preserve the presence of talented employees by offering a collection of financial incentives such as delayed compensation. Some poison pills- through the golden handcuff's technique- allow employees to cash in these incentives after a takeover, therefore giving them enough wealth to leave the company. This deprives the acquiring company of some of the target company's talent, therefore making the acquisition less attractive.

As the poison pill is such a powerful tool, its *impact* has naturally created opposing opinions as to its legal and ethical viability.

While this strategy offers many advantages such as avoiding hostile takeovers, helping the acquisition process to slow down and forcing the acquirer to sit on the negotiation table, it also poses many disadvantages if abused.

Naturally, acquisitive companies oppose the use of poison pills. They view this technique as a barrier to the free-market system, and as creating an environment whereby management can simply tie-up the free transfer of assets indefinitely.

The market in general has disfavor for poison pills as well. In many cases, when a company already in operation, adopts a poison pill, it is not uncommon to see a decrease in the value of the corporation. Such a decrease in price is attributed to the fact that investors view the adoption of the poison pill as management protecting its own interests. In other words, the market, like buyers, prefers the free transferability of company assets to ensure that they are placed in the hands of the most capable individuals.

Part 2: Real-World implementation of the poison pill strategy

A notable feature of this new generation of poison pills is their particularly low triggers. In the past, most plans were not triggered unless new investors acquired ownership of at least 15% of the companies' outstanding shares held on the open market. Today however, triggers of the poison pill are set at 10% or even lower.

Numerous examples on the implementation of poison pill strategies in famous companies such as Netflix, Disney and Twitter exist. We list below well-known past cases, in addition to the interpretation of the Twitter-Elon Musk case, still unresolved to this day.

- The pizza chain Papa John's adopted a poison pill strategy in July 2018, as a consequence of the company trying to block its founder from taking over. The poison pill would have allowed shareholders to buy stock at a discount if the founder, Mr. Schnatter, his family members or friends raised their stake in the company to 31 percent or if anyone else bought 15 percent of the stock without the board's approval. The dispute ended with a settlement in March 2019.
- Netflix successfully fended off the billionaire investor Carl Icahn in November 2012, using a poison pill strategy that would have made it more expensive for Mr. Icahn, or any other person or group, to accumulate more shares of Netflix if they acquired 10 percent of the company without the approval of its board.

- In September 1985, as a result of the spread of rumors that the consumer goods company Philip Morris was targeting McDonald's, the Corporation said it had adopted a poison pill plan to prevent "abusive takeover tactics." A few years later, the Walt Disney Company announced it had adopted one, calling it "a sound and reasonable means of safeguarding the interests of all stockholders."

In a more recent and famous case, Multi-billionaire Elon Musk offered to buy all of Twitter's outstanding stock for \$54.20 per share, valuing Twitter at approximately \$44 billion. As a result, Twitter's board of directors has publicly adopted the poison pill strategy on the 14th of April 2022, which would be activated if Musk's stake grew to 15 percent or more within a year. In that case, the introduction of new shares into the market would dilute the value of those shares.

Twitter announced in a statement that "The Rights Plan will reduce the likelihood that any entity, person or group gains control of Twitter through open market accumulation without paying all shareholders an appropriate control premium or without providing the board sufficient time to make informed judgments and take actions that are in the best interests of shareholders".

However, this poison pill plan came to an end on April 25, after an extended 24-hour negotiation, which resulted in Twitter executing a merger agreement with Mr. Musk, providing for the proposed ~\$44 billion purchase price.

Conclusion:

In drawing to the closure of the article, we assure that poison pill strategies are designed to protect companies from hostile takeovers. This self-defense method is activated when an investor's ownership exceeds a threshold set by the plan, resulting in the distribution of rights to the other stockholders at a discount, thereby making the acquisition more difficult and expensive.

In the current business and market environment, especially in light of the rapid and drastic swings in market values, the ability of the board to act swiftly becomes even more crucial. Any company without a poison pill plan should consider putting one on the shelf in the near term, just in case changing conditions or new threats require rapid adoption at a future date.

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