Stanford – Vienna
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European Union Law Working Papers

No. 52

Effectiveness of Poison Pills in European and International Law

Dora Klančnik

2021

European Union Law Working Papers

Editors: Siegfried Fina and Roland Vogl

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General Note about the Content

Suggested Citation

This European Union Law Working Paper should be cited as:
Dora Klančnik, Effectiveness of Poison Pills in European and International Law, Stanford-Vienna European Union Law Working Paper No. 52, http://ttlf.stanford.edu.

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Abstract

For decades now, takeovers have been a prevailing method for gaining corporate control on the active market. Growing competition led to development of a significant number of takeover strategies. That corporate control can be achieved through mutual negotiations, or in a hostile manner due to the resistance of the target companies. As a result of innovative and complex takeover strategies, target companies established a wide range of defences in order to protect themselves against the rivals and forestall the unwelcomed takeovers. While anti–takeover defences are either preventive or remedial, one of the most often used and effective ones are shareholder rights plans, commonly known as poison pills.

Although there is no precise definition of the term, poison pills can be perceived as a group of different defence mechanisms that operate similarly. Objective behind a typical poison pill is to dissuade the takeover attempt or at very least, force the bidder to pay a substantial premium to the target company's shareholders. Since they can either avert the takeover or raise the target company's and shareholder's value by persuading the bidder to increase its price, they are viewed as an effective takeover defence. However, there are two conflicting theories pertaining to the effectiveness of poison pills, each stating the polar opposite – that poison pills can either benefit or on the other hand only harm the target company and consequently the value of existing shareholders.

Poison pills are generally implemented by the target company's executives, meaning that their adoption is in hands of the managers or the board of directors. For that exact reason, the dilemma arises whether any specific issues can be encountered in that regard. This stems from the proposition that poison pills serve as a mechanism which puts incompetent managing boards in inherent position. Management entrenchment issue becomes all the more apparent when the managers, that adopted the poison pill, do not act in the interest of the target company's shareholders. Their implementation is neither risk free nor it is guaranteed that it will always carry beneficial effects irrespective of the effectiveness with which they block certain undesirable offers. Different jurisdictions approach the takeover laws and takeover defence regulations differently. Therefore, their efficiency will be evaluated within the jurisdictions that accepted them in their legal systems. The main focus of this master thesis shall be concentrated on the adoption and effectiveness of poison pills, and questions arising out of their usage.

For Stefan, my safe haven.

I would like to express my profound gratitude to prof. dr. Thomas Ratka, for mentorship, professional guidance and invaluable insights.

Deepest appreciation to my parents, for their relentless support and for always believing in me.

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TABLE OF ABBREVIATIONS

CAP	Customer Assurance Plan
e.g.	exempli gratia (for example)
edn.	edition
EU	European Union
i.e.	id est (that is)
ibid.	ibidem (in the same place)
n	note
No.	number
v.	versus (against)
vice versa	the other way around

1. INTRODUCTION

1.1. Determination and Description of the Subject Matter of Master's Thesis

Shareholder's rights plan strategies, colloquially known as a "poison pills," are one of the most common anti–takeover defence mechanisms, used by the target company's management or board of directors in a battle against a hostile takeover, and perhaps even the most effective one. Although they are not always the first line of defence, poison pills protect the target company's shareholders and avoid unnecessary changes of control in the target company's management. Their nature creates a unique and interesting situation as they have a significant potential to either benefit or harm the shareholders, and are generally adopted by the board of directors without the shareholder's opinion.[1] As to their effectiveness and legality, they have generated many questions and gave rise to many heated debates among academics and practitioners.[2]

Poison pills fall into the scope of preventive defence measures, which are adopted in the event of a hostile takeover attempt. Their typical objective is to either avert the hostile bidder and block an unwelcomed takeover, or to force the bidder to pay a substantial premium to the target company shareholders and consequently raise their value by increasing the power of target company's management and issuing additional shares to existing shareholders.[3] However, poison pills can also be a reflection of how certain *remedies* can quickly turn into *venom* if they are used in disproportioned doses. There are several questions that arise when assessing the effectiveness of these types of takeover defences, primarily how much is too much and how can the actual effect of the poison pill be quantified. Moreover, is it only the severity of the measure (implying the quantity of effects) affecting the final outcome or should the quality and the approach in the implementation have any bearing on the ultimate effectiveness.

[1] Donald DePamphilis, *Mergers, Acquisitions, and Other Restructuring Activities* (8th edn, Elsevier Science & Technology 2015) 109.
[2] Dindual Sunder, 'The Controversial 'Poison Pill' Takeover Defense: How valid are the Arguments in Support of it?' (2013) NMIMS Management Review 49.
[3] Michael A Hitt and others, *Mergers and Acquisitions: A Guide to Creating Value for Stakeholders* (1st edn Oxford University Press 2001) 75.

All of the mentioned contemplations must be analysed in order to determine what line *must not* be crossed in order for poison pill to remain a remedy and not live up to its name and turn into the poison for ones implementing it.

1.2. Objective of Master's Thesis

The objective of this thesis shall be researching to what extent poison pills can be seen as an effective tool, used against hostile takeover attempts. Although it is undeniable that poison pills do not always avert the hostile takeover and do not always provide the target company with benefits, it is necessary to determine whether they can still be seen as an effective defence strategy even when the takeover is not averted. Specifically in relation to the consideration whether when used properly they raise the value of the target company and its existing shareholders or do they only serve as a means to entrench the incumbent management.

There are two main propositions that shall be thoroughly analysed and evaluated throughout this thesis. First, that a poison pill is a low risk, but a high reward method against (hostile) takeovers. And second, that the use and adoption of a poison pill surpasses 'simple' classification as only being a defence method, but also a strategy to gain a leverage and additional bargaining power within the negotiating process.

1.3. Assumptions and Potential Limitations of Master's Thesis

This thesis will focus on the legal institutes within the field of international and European corporate law. The intent of this thesis is to elucidate the issues and specifics arising out of the usage of poison pills and other accompanying takeover defence mechanisms. To accomplish this goal, different aspects of these types of anti–takeover mechanisms will be carefully examined, primarily their effectiveness, legal status, advantages and potential risks associated with their adoption. However, there are certain constraints connected to the researched topic, that present possible limitations as to the length and focus of this thesis. Further there are limitations in regard to the access to all the relevant information and its diversity. Namely, with respect to the case law it can be expected that available cases will deal mainly with issues pertaining to the poison pill implementation. There is a concern that there will not be sufficient amount on practical information in cases where defence was successful.

Thus, it remains to be seen whether this limitation shall have a significant impact on assessment and evaluation of the poison pill effectiveness.

1.4. Research Methodology

When pursuing the aim, subject matter and the objective of this thesis, poison pills in international and European corporate law shall be the main focus of the research. In respect to the adoption of takeover defence mechanisms it can be expected that different situations will provide with different outcomes, meaning that not every implementation will have a definitive effect regardless of circumstances. While several takeover defences will be addressed throughout this paper the main focus shall remain on the poison pills and their specifics. It can thus be anticipated that not every adoption of a poison pill will be successful or effective in the way target company might count on. For this reason, various aspects will be considered in order to perceive different perspectives correlated to these mechanisms as to gain comprehensive understanding of the subject matter and its effectiveness. Their legal position and case law in different legal systems will be analysed to reach the most pertinent conclusions. Therefore, implementation of comparative method shall bear a significant importance.

Additionally, to establish a framework and foundation of this thesis, the description of peculiar legal institutes that are linked to poison pills is inevitable. In order to fully understand the controversy behind poison pills, their process of operating must be defined and thoroughly evaluated. Thus, descriptive method shall be used to enlighten all parallels and related principles.

Lastly, the method of data compilation and analysis shall be used. In order to demonstrate common approaches, decisions, and to conclude the most important arguments, it will be first and foremost necessary to compile all the relevant case law and legal practice. While it is not a goal of this thesis to analyse specific case law, special attention will be given to selected cases which provide valuable insights and deserve individual analysis.

In the course of the writing of this thesis, three aforementioned primary research methods are expected to be used – comparative, descriptive, and method of compilation and analysis. Nonetheless, it is important to note that the mentioned choice of methods is neither finite nor exclusive, but merely expected ones for the purposes of this thesis.

2. BASICS OF MERGERS AND ACQUISITIONS

With an ever-growing global market of countless corporations and ruthless competition, different corporations always aspire to boost their growth and control on the battlefield of the active market. There are numerous approaches that can be utilised to achieve aforementioned aims.[4] Further, important distinction should made with respect to, first, the changes from within the company itself, and second, with gaining control over another company. Control over another company can be achieved by the way of either merger or an acquisition.[5] These two terms are often used as two sides of the same coin, although they entail different types of transactions, but with the similar end result – transfer of control over a part of the company's assets or the entire company. Nevertheless, if these two actions are put side by side, differentiation can already be seen through their definitions. A merger involves two or more companies that join together to become one bigger company, while in an acquisition one company purchases assets or shares of another company.[6] To simplify, the common denominator of such transactions is a shift *of* the control or *in* the control. For the purpose of this master thesis, the term takeover will be used to address both, merger and acquisition, to avoid unnecessary distinctions where they are not crucial.

Further, subdivisions of takeovers should be highlighted. Two ways of acquiring another company exist within, namely friendly and hostile takeovers. Due to the increased presence of takeover activities on a global corporate market, hostile takeovers have been extensively explored during the past decades.[7] As a result of the complex takeover strategies, anti–takeover strategies arose. Among the most frequently employed defences by the target companies are the shareholder rights plan strategies, known as "poison pills," which have raised many questions among academics and practitioners as to their effectiveness and legality.[8]

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[4] Mohit Chawla, 'Antitakeover Defense, Efficiency & Impact on Value Creation' (2015) HEC School of Management, Paris, 13 <https://www.vernimmen.net/ftp/RESEARCH_PAPER_MOHIT_CHAWLA_SSDN.pdf> accessed 6 May 2021.
[5] Daniëlle Timmers, 'The Takeover Landscape in the United Kingdom, the Netherlands and the United States' (2018) Tilburg University, Netherlands, 11 <http://arno.uvt.nl/show.cgi?fid=147538> accessed 7 May 2021.
[6] Andrew Sherman, *Mergers and Acquisitions from A to Z* (2nd edn, AMACOM Division of American Management Association International 2011).
[7] Marina Martynova and Luc Renneboog, 'A Century of Corporate Takeovers: What Have We Learned and Where Do We Stand?' (2008) Journal of Banking and Finance, 2 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=820984#> accessed 6 May 2021.
[8] Sunder (n 2) 49.

3. TAKEOVERS

Takeovers are an integral component of corporate law and have attracted significant attention in jurisdictions around the world.[9] Especially in the modern markets of the business world, takeovers present the prevailing method of gaining control of one company over another.[10] The term defines itself as *an act of taking over* and it is used to describe a situation in which the acquiring (or bidding) company acquires the shares from the target company. These shares must represent at least a controlling percentage of the voting rights.[11] With that kind of purchase the acquiring company becomes the holding company of the target one, which consequently becomes a subsidiary.[12] Takeover usually occurs when and if the bidder is interested in acquiring certain assets of the target company that could later be used to increase the economic value of potential post-merger corporation.[13]

This result can be achieved in two different approaches and an important distinction must be made between the two. Takeovers can be voluntary and friendly, meaning that they are initiated by a mutual decision of two companies, where the target company is receptive to the idea of takeover and consequently willingly acquired by another company.[14] Thus, they are perceived to create synergy through the combination of businesses which results in a negotiated agreement without bidder resorting to aggressive approaches. Nevertheless, that is not always the case. While the vast majority of mergers and acquisitions do take place in *friendly* circumstances, they can be accomplished (without cooperation of all of the involved parties) unfriendly as well. In such cases the larger company takes over the smaller one without its consent or full agreement.[15]

[9] Hui Huang Robin and Juan Chen, 'The Rise of Hostile Takeovers and Defensive Measures in China: Comparative and Empirical Perspectives' (2019) 20/2 European Business Organization Law Review, 3 <https://ssrn.com/abstract=3437697> accessed 9 June 2021.
[10] Adriaan Dorresteijn and others, *European Corporate Law* (3rd edn, Wolters Kluwer 2017) 95.
[11] ibid.
[12] Nicholas Bourne, *Bourne on Company Law* (7th edn, Routledge 2016) 352.
[13] Kent H Baker and others, *The Art of Capital Restructuring: Creating Shareholder Value Through Mergers and Acquisitions* (1st edn, John Wiley & Sons, Incorporated 2011) 324.
[14] Will Kenton, 'Takeover' (*Investopedia*, 24 November 2020) <https://www.investopedia.com/terms/t/takeover.asp> accessed 6 May 2021.
[15] ibid.

3.1. Hostile Takeovers

A key characteristic of every takeover is the perceived aggressiveness of the bidder.[16] While both, friendly and hostile takeovers, share a similar motive of gaining corporate power, there is a thin line between what is characterized as what, since there is a possibility that a friendly bid develops into a hostile one.[17] That can be substantiated with empirical observation indicating claims, that most takeover attempts are initiated under friendly circumstances and that they only converge to unfriendly, hostile approach, when confronted with resistance.[18] However, it does not matter if those claims are true or not. Contrary to a well-organized negotiation process of a friendly takeover, hostile takeover occurs when the target company explicitly opposes the bid, placed by the bidder.[19] If the target company rejects bidder's initial bids and efforts to take over the company, bidder may decide for a more aggressive approach in order to achieve its goal. Thus, the bidder attacks the target company without any further notice that could endorse the target company to adopt any defence measure.[20] The bidder approaches the target company's shareholders directly, either by making a tender offer or through a proxy fight.[21] A tender offer is an offer addressed directly to the target company's shareholders in order to purchase their shares at a premium to the market price.[22] The goal behind it is to obtain sufficient amount of voting shares to acquire a majority stake in the target company. A proxy fight on the other hand, is carried out by the bidding company, which persuades the existing shareholders of the target company to vote out and remove the board members opposing the takeover. The rationale behind a proxy fight is therefore to establish new management, more receptive to a change and takeover by the bidding company.[23] However, no matter which one is used, a tender offer or a proxy fight, the goal of the bidder is to achieve control over the target company.[24]

[16] Baker and others (n 13) 327.
[17] Samim Zarin and Erik Yang, 'Mergers & Acquisitions: Hostile takeovers and defense strategies against them' (2011) School of Economics, Business and Law, University of Gothenburg, 11 <https://gupea.ub.gu.se/bitstream/2077/28242/1/gupea_2077_28242_1.pdf> accessed 9 June 2021.
[18] Chawla (n 4) 13.
[19] Jeannette Gorzala, *The Art of Hostile Takeover Defence* (1st edn, Igel Verlag Fachbuch 2010) 7–8.
[20] Chawla (n 4) 13.
[21] Baker and others (n 13) 325.
[22] Gorzala (n 19) 12.
[23] Chawla (n 4) 21.
[24] DePamphilis (n 1) 99.

Respectively, hostile takeovers are often perceived as a threat to shareholders, executives and directors, as they take place against their will and challenge the strategic direction and leadership of the target company.[25]

It is sometimes difficult to draw a clear line between a friendly and hostile takeover. Such distinction is rather complex, since public announcements of takeover attempts are an integrated part of friendly takeover's negotiating strategies. Additionally, as with any negotiation, circumstances change over time and with them also the attitudes and expectations of the parties involved. Therefore, many transactions that initially might have seemed hostile can at the end result in a friendly negotiated settlement and vice versa.[26]

3.1.1. Motivation Behind a Hostile Takeover Attempt

Although rationale behind a hostile takeover is similar as with other acquisitions, there is a distinctive motive behind a hostile bid, that can be a persuasive factor while deciding whether a takeover is deemed friendly or hostile. It is believed that a hostile approach is the most effective way of replacing an ineffective management of the target company.[27] A company can have a great growth potential which is jeopardized if its management is incompetent. The bidding company therefore aims to replace it, in order for the company to achieve its full revenue, consequently increasing its share value.[28] The takeover process is thus unlikely to be friendly as the bidder will aim to replace the target company's management, and the target management will not react positively. For this reason, (target) companies with the existing management that does not seek the best interests of its shareholders, are frequently subject to potential forthcoming takeovers.

3.1.2. Economic Rationale

Takeovers are seen as tools of exercising control over the target company's management and increasing and strengthening the active market in which the companies partake. [29]

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[25] John A Pearce and Richard B Robinson, 'Hostile takeover defenses that maximize shareholder wealth' (2004) 47/5 Business Horizons, 16 <https://doi.org/10.1016/j.bushor.2004.07.004.> accessed 6 May 2021.
[26] William Schwert, 'Hostility in Takeovers: In the Eyes of the Beholder?' (2000) 55/6 The Journal of Finance, 2600 <http://www.jstor.org/stable/222395> accessed 9 June 2021.
[27] Zarin and Yang (n 17) 11.
[28] ibid.
[29] Gorzala (n 19) 8.

From the corporate point of view, the bidder's primary motivation is connected to the *synergy* benefits that arise from multiple sources. Meaning that the transaction must produce economic gains and increase shareholders' wealth. The term synergy stands for the potential additional value of the entity emerging from combining two companies.[30] Accordingly, synergy can generally be segmented into operational synergies that are related to the operating cycle and cost reduction, and financial synergies that refer to the possibility of optimizing the cost of capital of combined entity.[31]

3.1.3. Operational and Financial Synergies

Both types of synergy gains, operational and financial, are usually perceived to be positive for the target and the bidding company.[32] These types go hand in hand and fulfil each-other. On one hand, operating synergies primarily measure the efficiency of the benefits (profit) earned from economies of scale and scope, and the achievements from balancing technical assets and skills. Thus, profits in efficiency come from these factors and from improved managerial operational practices, which can be important determinants for the creation of shareholder's wealth. Meaning, the greater the operational efficiency, the greater the investment (merger or acquisition). On the other hand, financial synergies refer to the optimized costs of capital of the combined entity. From the perspective of the target company, financial synergies arising from a takeover can also be perceived as a *removal* of certain monetary limitations, that are often connected to significant investment opportunities, that the company has no ability to fund.[33] These financial limitations lead to increased holdings in cash, because constrained companies (i.e., those which cannot finance given investment opportunities) tend to reduce their cash holdings and try to expand their investments. When target companies are taken over, their financial constraints and limitations are reduced accordingly.[34] In regard to the bidder's strategic motivation, it has to be noted that takeovers generally perform an important role.

[30] Lennart Horst Michael Junge, 'Operating Synergy Types and Their Impact on Post-merger Performance' (2014) Tilburg University, Netherlands, 10 <http://arno.uvt.nl/show.cgi?fid=135896> accessed 9 June 2021.
[31] Taher Hamza, Sghaier Adnène and Mohamed Thraya, 'How do Takeovers Create Synergies? Evidence from France' (2016) 11/1 Studies in Business and Economics, 55 <https://www.sciendo.com/article/10.1515/sbe-2016-0005> accessed 9 June 2021.
[32] ibid.
[33] DePamphilis (n 1) 12.
[34] ibid.

The target or the bidding company can achieve market entry or exit, improvement of its position on the same market, and gain access to new technology or human capital through a broad spectrum of possible strategic approaches. These approaches involve either hostile offers or strategic placements of takeover defences, depending on the company's goal and way of operating. All taken actions create the company to be more competitive in the marketplace and consequently contribute to its long-term success by optimally allocating resources. [35]

3.1.4. Management Control

As noted above, the main factor that distinguishes a hostile takeover from a friendly one is the bidder's particular intention to gain a control over target company and raise its potential value by establishing a more efficient management. The change of a management or board of directors in a target company is usually necessary or at least what keeps the bidder interested, as managers and directors are the shareholder's agents, but they both have different and their own interests, which can lead to a conflict of opinions between them in terms of what the right choice is for the company. That is favouring a bidder, as company gets weaker if there is no communication and agreements between its owners and executives. For example, the best executives almost always strive to constantly evolve the business of the company which they are working for, due to the power and reputation that come with the size of the company.[36] When management boards are more concerned with expanding the business and with increasing the value of assets rather than optimally allocating resources and employing beneficial strategies for the existing shareholders, it means that they won't necessarily engage in actions, best for the growth of the company or its shareholders. Thus, takeovers play a significant role in monitoring the existing managers of the targeted company and aligning their motivations with shareholder's interests, which is in favour for the bidder.

3.2. Takeovers Defences

As a response to the ongoing battles of gaining corporate control on the active market, companies have created a selection of sophisticated defence mechanisms to preserve their independence against unwelcome and hostile takeover attempts.[37]

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[35] Gorzala (n 19) 10.
[36] ibid.
[37] Richard Schoenberg and Daniel Thornton, 'The Impact of Bid Defences in Hostile Acquisitions' (2006) 24/3 European Management Journal, 142 <https://doi.org/10.1016/j.emj.2006.03.004> accessed 6 May 2021.

Formation of a defence strategy is nowadays one of the essential considerations for every company, as a carefully drafted strategy can help the target company to abide a hostile takeover attempt. Takeover defences include all actions adopted by the target company in order to protect its independence.[38] Several defence mechanisms that have evolved over the past two decades,[39] serve as a tool for the target company to employ in order to deter and slow down an unwanted, hostile takeover or exert pressure on hostile bidders to attain a higher offer.[40] The significant number of anti-takeover defence mechanisms can be classified into two categories – first, those put in place before an actual offer aimed to discourage bidders from making one (pre-offer defences), and second, those employed as a direct response to a received offer (post-offer defences).[41] The following section of this master's thesis analyses and distinguishes between the most common anti–takeover defence strategies.

3.2.1. Pre–Offer Defence Strategies

Pre-offer or preventive defence strategies are, as it can be drawn from the name itself, constructed when the target company's executives anticipate a pending attack when the company is perceived as vulnerable.[42] Such defences are thus adopted before an actual offer is received, with the intention to make the target company unattractive to a potential bidder and to reduce the probability of a successful (hostile) takeover.[43] Pre-offer defences are not only aimed at defending and delaying hostile takeover attempts, but also designed to retain corporate value of the target company.[44] However, the adoption of those measures does not necessarily have the power to block a hostile takeover,[45] but it may give the target company additional time to develop the most effective strategy against the upcoming takeover.[46]

[38] Chawla (n 4) 6.
[39] Shawn C Lese, 'Preventing Control from the Grave: A Proposal for Judicial Treatment of Dead Hand Provisions in Poison Pills' (1996) 96/8 Columbia Law Review Association, 2175 <https://doi.org/10.2307/1123419> accessed 9 June 2021.
[40] Zarin and Yang (n 17) 17.
[41] DePamphilis (n 1) 108.
[42] Pearce and Robinson (n 25) 18.
[43] DePamphilis (n 1) 108.
[44] Timmers (n 5) 14.
[45] Stefania Alexandrina Naicu-Svaiczer, 'Hostile takeovers and takeover defence mechanisms. The case of Cadbury Plc. and Kraft Foods Inc.' (2012) University of Vienna, Master's Thesis, 10 <http://othes.univie.ac.at/22606/1/2012-08-29_0552311.pdf> accessed 6 May 2021.
[46] Chawla (n 4) 25.

Among the most commonly applied preventive anti-takeover mechanisms are golden parachutes, staggered boards, and poison pills. The later are the most popular and will be more thoroughly addressed and analysed in the following chapters of this master's thesis.

3.2.2. Post–Offer Defence Strategies

Should pre-offer defences fail, target company can further combat the takeover with several post-offer (re)actions.[47] Hence, post-offer or remedial defence strategies are adopted after the action of hostile takeover on target company has already occurred and actual offer has already been received.[48] Such measures are employed as a direct response to the received offer and aggressive and hostile nature of the bidder's strategy.[49] Unlike pre-offer defence strategies that are more concerned with proactive steps, post-offer defences involve tactics aimed at elimination of the items of bidders' interest. It was previously mentioned that hostile takeover attempts are often a result of bidder's interest in certain assets of the target company and for that reason post-offer tactics involve destroying potential synergies by eliminating the item(s) of bidder's interest.[50] Nevertheless, it has to be noted that although these mechanisms have the power to successfully avert hostile takeovers, they may come with a high price for the target company and its shareholders. If the economic value of the target is decreased to make it less attractive for the bidder, shareholders will accordingly undergo the consequences of decreased share value.[51] Multiple post-offer mechanisms, where each of them is specific in response to the bidder's strategy, include corporate restructuring, white knights, white squires, and others.

4. POISON PILLS

Shareholder rights plans, colloquially known as poison pills, are among the most popular and widely used preventive takeover measures.[52] Although they are a relatively recently developed strategy and arguably one of the most significant legal innovations in corporate law in the 20th century, they are certainly the most controversial in relation to other takeover defences.[53]

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[47] Gorzala (n 19) 47.
[48] DePamphilis (n 1) 117.
[49] Gorzala (n 19) 1.
[50] Baker and others (n 13) 347.
[51] ibid.
[52] Pearce and Robinson (n 25) 18.
[53] Timothy Harper, 'How Martin Lipton changed corporate law' (*New York Metro Super Lawyers Magazine*, 25 September 2013) <https://www.superlawyers.com/new-york-metro/article/a-boardroom-lawyer/5e44a629-1d0e-4262-9412-e52c84f5a50a.html> accessed 15 May 2021.

The name itself already carries a foreboding implication. Every phenomenon has its own story behind and poison pills are no exception. Rather peculiar name owes its origin to the practice of spies back in the time of wars in the monarchical era, when the tradition of espionage was prevalent.[54] If caught, spies swallowed cyanide pills in order to escape the interrogation by their enemies, similar to how a target company uses a poison pill in order to make its shares unfavourable and the company less appealing to the bidder in order to avoid a hostile takeover. Poison pill strategy was initially used in the 1980s, as a response to that period's heavy volume of hostile takeover activity.[55] Prior to that, there was no legalized defence tactic in place.

Poison pill was designed to impede hostile bidders from acquiring majority of the target company's shares. Consequently, tender offers made without other acquisition plan became more or less powerless, giving the target company more time to set forth additional defence strategies.[56] The term *poison pill* has no precise definition and it does not refer to one single method or strategy.[57] Rather, it refers to a group of different mechanisms that operate in a similar manner. Generally, the objective of a *typical* pill is to increase the power of management and to help to successfully block a takeover attempt or *at least* force the bidder to pay a substantial premium to the target company shareholders.[58] Adopting the poison pill allows existing shareholders of the target company to issue and purchase more shares with lower than the actual market share price is.[59] The logic behind it is to increase the number of existing shares on the market and consequently dilute the shares of the target company.[60] With that the bidder would need to purchase more shares to achieve the control over its target. As a result, that the bidder loses resources on its investment, which makes the takeover harder and prohibitively expensive, and thus less attractive.[61] The power to redeem a poison pill is vested in the target company's management board, meaning that generally no shareholder approval is needed.[62]

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[54] ibid.
[55] Harper (n 53).
[56] Michael Klausner, 'Fact and fiction in corporate law and governance' (2013) 65/6 Stanford Law Review, 1350.
[57] Charles M Yablon, 'Poison Pills and Litigation Uncertainty' (1989) 38/1 Duke Law Journal, 58 <https://scholarship.law.duke.edu/dlj/vol38/iss1/3> accessed 9 June 2021.
[58] Hitt and others (n 3) 75.
[59] Baker and others (n 13) 341.
[60] Klausner (n 56) 1350.
[61] Alan J Auerbach, *Mergers and Acquisitions* (1st edn University of Chicago Press 1987) 54.
[62] Klausner (n 56) 1350.

A company's board can unilaterally adopt a poison pill at any given moment, typically as soon as the bidder tries to obtain a certain percentage of the target company's shares.[63] Meaning, a poison pill can be implemented in several different forms, to match the needs and goals of the target company that is utilizing it. While possible alternatives and variations are left to the individuals' creativity, there are some standard variations and provisions that encompass the core of every poison pill.[64] Nevertheless, there are many different forms regarding how and when the new shares or the rights to acquire these shares are issued.

4.1. Types of Poison Pills

Over the past two decades, in its brief life, the poison pill has rapidly progressed into many different forms. Its evolutionary process was mostly stimulated by judicial (re)actions and the increasingly complex, strategic tactics of bidders.[65] Thus, the selection of the most appropriate type of the poison pill depends on the bidder's strategy, as well as to what the target company seeks to achieve with the adoption of a poison pill, regarding how and when the new shares or rights to acquire these shares are issued.[66] In a practical corporate setting, five major methods of poison pills exist, however in this section, three different variations will be discussed as of how they have historically developed over the three decades.

The first-generation, the earliest version of poison pills, is the *Convertible Preferred Stock Provision*. Pursuant to this plan, the target company issues convertible preferred stocks at a discount, in the form of a dividend, to its existing shareholders.[67] In the event of a successful takeover attempt, preferred stock owners are granted the right to convert their preferred stock into a common stock. It can thus be claimed that the bidder's offer will not be accepted by the shareholders, since they are guaranteed to receive discounted shares, issued by their company.[68]

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[63] This is the case for the United States, while other jurisdictions may require prior approval of shareholders. However, that shall be more specifically elaborated in the following sections.
[64] Julian Velasco, 'Just Do It: An Antidote to the Poison Pill' (2003) Notre Dame Law School, 856 <https://core.ac.uk/download/pdf/268222425.pdf> accessed 9 June 2021.
[65] Robert F Bruner, 'The Poison Pill Anti-takeover Defense: The Price of Strategic Deterrence' (1991) The Research Foundation of the Institute of Chartered Financial Analysts, 12 <https://www.cfainstitute.org/-/media/documents/book/rf-publication/1991/rf-v1991-n1-4431-pdf.ashx> accessed 9 June 2021.
[66] Baker and others (n 13) 342.
[67] Bruner (n 65) 12.
[68] Suzanne S Dawson and others, 'Poison Pill Defensive Measures' (1987) 42/2 The Business Lawyer, 430 <www.jstor.org/stable/40687130.> accessed 20 May 2021.

While preferred shares do not vest shareholders with voting rights, under certain conditions, they can be converted into common stocks and the voting right is brought into existence. Additionally, the transaction becomes less interesting for the bidder as the bidder loses voting power when the provision is triggered.

The second and third-generation pills include the so-called *Flip–Over* and *Flip–In poison pill.* The former releases its poison after it is certain that the takeover will take place. In essence, the Flip-Over pill allows existing shareholders of the target company to purchase additional shares at a significant discount, either in the bidding company or in the company emerging from the takeover.[69] As that is more profitable for the existing shareholders, the bidder's offer will most likely be accepted. However, there is possible drawback connected to the Flip–Over strategy. Given rights are not exercisable unless the bidder utterly acquires the target company.[70] Therefore, such type is *only* or the most useful when the target company is trying to prevent a full takeover. Thus, although that Flip–Over rights do not prevent takeovers, they significantly increase its cost and further tend to transfer wealth from the bidder's company shareholders to the shareholders of the target company.[71] As a consequence, because bidder has to compensate its shareholders due to the dilution of the newly issued shares, the completion of a takeover might not be as appealing anymore. It was mentioned that the Flip–Over pill is triggered after the takeover. On the contrary, the Flip–In pill takes place beforehand. Comparable to the Flip–Over, the existing shareholders get the right to buy additional shares at a discount, only this time the shares of the target company, instead of the company emerging from the takeover or the bidder's company.[72] As these rights increase the number of shares of the target company, that means that the takeover will consequently come with a higher cost for the bidder. Subsequently, regardless of which type is used, Flip–Over or Flip–In, the bidder must produce more shares in either case. Distinguishing factor between the two is a matter of purchasing shares in the target or in the bidder's company.[73] It can be concluded that although the purpose of both types is the same, merely their effect is manifested in an opposite direction.

[69] Bruner (n 65) 73.
[70] Pearce and Robinson (n 25) 18.
[71] Zarin and Yang (n 17) 17.
[72] Bruner (n 65) 73.
[73] Malin Hamnered, 'The Takeover Directive and Its Implementation in Germany, UK and Sweden' (2012) Lund University, Sweden, 14 <https://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=3052601&fileOId=3162138> accessed 9 June 2021.

4.2. Legal Constraints

With their fairly aggressive nature, poison pills may cause several potential difficulties along the way. There is case to be made that the poison pill's best feature is correspondingly its greatest imperfection and weakness – the more effectively that particular pill operates to deter a takeover, the less likely it is to survive a court's hearing.[74] Since their introduction, poison pills have inspired dissent and raised a number of legal questions as to their destructive potential that strongly differs from the parameters of takeover defence debate amongst scholars and practitioners.[75] Before contemplating the effectiveness of poison pills, it is most important to analyse their legal position. And in order to fully comprehend their place within legal framework, it is important to review their legal history, which has been nothing less than remarkable.[76]

While the poison pill is a well-established instrument against hostile bids in the United States, many other jurisdictions do not permit its use and/or consider it illegal.[77] In fact, takeover laws in United States and other jurisdictions, such as United Kingdom, Australia, Japan and European Union (hereinafter: EU), have different origins and have thus followed diverse approaches while distributing the power between target companies and bidders in takeover battles.[78] This section will begin with a history of the poison pill in United States, specifically Delaware, the state that dominates the field of corporate law.[79] Thereafter, a brief description of other jurisdictions will follow.

[74] Gregory P Williams and others, 'Poison Pills - How Effective Is Too Effective?' (2010) 14/8 The M&A Lawyer, 1 <https://www.rlf.com/wp-content/uploads/2020/05/SEPTFINALedited.pdf> accessed 9 June 2021.
[75] David Kershaw, 'The illusion of importance: Reconsidering the UK's takeover defence prohibition' (2007) 56/2 International and Comparative Law Quarterly, 269 <http://eprints.lse.ac.uk/23662/> accessed 9 June 2021.
[76] Julian Velasco, 'The Enduring Illegitimacy of the Poison Pill' (2002) Notre Dame Law School, 385 <https://scholarship.law.nd.edu/cgi/viewcontent.cgi?article=1728&context=law_faculty_scholarship> accessed 9 June 2021.
[77] Gorzala (n 19) 1.
[78] Jennifer G Hill, 'Takeovers, Poison Pills and Protectionism in Comparative Corporate Governance' (2010) Law Research Paper 168/2010, 5 <http://ssrn.com/abstract=1704745> accessed 9 June 2021.
[79] Velasco, 'The Enduring Illegitimacy of the Poison Pill' (n 76) 385.

4.2.1. United States

Widespread implementation of poison pills in the United States started as a response to frequent hostile takeover practice by institutional investors.[80] Shareholders allowed managements to adopt defensive provisions in line with their own judgement, whenever they considered such adoption necessary, without the approval of shareholders.[81] The validity of poison pills has first been established and never really in question in Delaware.[82] However, in other states across the United States their status was not as clear cut. Before poison pills as such could be perceived as legitimate, the legitimacy of defensive strategies in general had to be authorized. Delaware's general policy towards defensive strategies was first accepted by the Delaware's Supreme Court (hereinafter: Delaware's Court) in *Unocal v. Mesa Petroleum* (hereinafter: Unocal)[83] and eventually restated in *Unitrin v. American General.*[84] Delaware's Court acknowledged a possibility that directors can abuse defence strategies to strengthen their positions.[85] Regardless of certain nuances, Delaware's policy can now be (if conclusions are to made in accordance these two decisions) summarized to be understood that a company's board is permitted to resist a hostile takeover if that attempt presents a reasonable threat to corporate policy and its effectiveness, if the response is reasonable in relation to the threat posed (Unocal standard).[86]

Soon after defensive measures as such were approved to use, Delaware's Court recognized the concept of a poison pill specifically as a valid defensive strategy against hostile takeovers. The leading case in that regard was case *Moran v. Household International, Inc*. (hereinafter: Moran),[87] where the court noted that poison pill does not harm the target corporation as much as other defensive mechanism do. Although in *Moran*, the only poison pill that was used was Flip-Over pill, it proved to be the decisive case.[88] *Unocal* and *Moran* gave companies legal support to use their "business judgment" in order to install defences.

[80] Bruner (n 65) 40.
[81] Hill (n 78) 3.
[82] Velasco, 'The Enduring Illegitimacy of the Poison Pill' (n 76) 385.
[83] *Unocal Corp. v. Mesa Petroleum Co*., 493 A.2d 946 (Del. 1985).
[84] *Unitrin, Inc. v. American General Corp*., 651 A.2d 1361 (Del. 1995).
[85] Joseph M Grieco, 'The Ever-Evolving Poison Pill: The Pill in Asset Protection and Closely-Held Corporation Cases' (2011) 36/2 Delaware Journal of Corporate Law 629.
[86] ibid 629.
[87] *Moran v. Household International, Inc*., 500 A.2d 1346 (Del. 1985).
[88] Velasco, 'The Enduring Illegitimacy of the Poison Pill' (n 76) 390.

In judgements following these two landmark decisions the courts continued to follow previous rationale and relied on *Moran* to validate other forms of poison pills.[89] Although the corporate law of Delaware generally allows the use of poison pills, in relatively rare cases particular types have been declined. However, there are still mixed opinions about the validity of poison pills outside of Delaware, where the legal history of poison pills has most certainly been more volatile.[90] At the beginning, courts could not reach a common ground while weighing the reasons for and against the validity of poison pills. Eventually, the reasoning of cases that have previously uphold the validity prevailed and even in states where the pill was firstly declared *ultra vires*, companies were given the permission to adopt such measures when necessary.[91]

4.2.2. United Kingdom

Meanwhile the takeover defence strategies, in particular poison pills, have their roots in corporate law of United States, takeovers as such emerged earlier in the United Kingdom than the United States.[92] However, the United Kingdom did not replicate the widespread use of takeover defences and specifically poison pills. Whilst those are popular and pervasive in the United States, they face significant obstacles in the United Kingdom.[93] A simple answer as to why can be given by a number of scholars – regulatory structure. The United Kingdom under the City Code on Takeovers and Mergers (hereinafter: City Code) favours for shareholders' interests, unlike the United States which support managements.[94] Rule 21 of the City Code provides a common prohibition of so-called *frustrating board actions* (i.e., the non-frustration rule), together with a detailed set of additional prohibitions, which was introduced in the United Kingdom as a response to the abuse of the company's board power to issue shares in cases against hostile takeovers.[95]

[89] See cases such as *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*., 506 A.2d 173 (Del. 1986); *Unitrin, Inc. v. American GeneralCorp.,* 651 A.2d 1361 (Del. 1995); *Leonard Loventhal Account v. Hilton Hotels Corp*., C.A. No. 17803 (Del. Ch. 2000).
[90] Velasco, 'The Enduring Illegitimacy of the Poison Pill' (n 76) 398.
[91] ibid.
[92] The regulation of takeover in the United Kingdom dates all the way back to the 1959, as a response to a number of takeover bids. For a more comprehensive study of takeover history in the United Kingdom, see Ferna Ipekel, 'A Comparative Study of Takeover Regulation in the UK and France' (2004) University of London <https://etheses.lse.ac.uk/1805/1/U198885.pdf> accessed 9 June 2021.
[93] Timmers (n 5) 19.
[94] Hill (n 78) 5.
[95] Kershaw (n 75) 267.

Target companies are thus prohibited from taking any action which might frustrate a takeover offer without the approval of its shareholders.[96] The objective of the non-frustration rule is to protect shareholders from managerial abuse.

Therefore, with the exception of issuing golden shares,[97] poison pills have rarely been encountered or indeed countenanced by bidders and institutional investors.[98] Although the verge of acceptable defensive actions might have been limited by the City Code, the target companies established new methods in order to prevent hostile takeovers and managed to find a solution against frustrating action in spite of limiting legislation. In particular, target companies now take great advantage of the terms for the mandatory offer provision in the City Code, which eliminates possibilities of any partial offers.[99]

4.2.3. European Union

In the EU, takeovers and takeover defence strategies are regulated with the Takeover Directive[100] that has influenced local regulation of takeovers in its Member States.[101] As of Directive's prolonged history, it is important to address the drafting process, in order to clarify its ultimate impact on the takeover regulation. Upon its first introduction it enflamed ample discussions on the topic, mostly criticism, due to the nature of its proposed substance. According to the European Commission, the aim of the Takeover Directive was to create a harmonised legal framework for takeovers within the EU.[102]

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[96] Sarah Beaumont, Nigel Stacey and Sian Williams, 'Are poison pills finally coming to the UK?' (*Financier Worldwide Magazine*, February 2021) <https://www.financierworldwide.com/are-poison-pills-finally-coming-to-the-uk#.YLSZXS0RpbU> accessed 9 June 2021.

[97] *Golden shares* are nominal shares that grant a decisive vote to its holders, to veto major corporate decisions in certain circumstances.

[98] Sarah Beaumont, Nigel Stacey and Sian Williams (n 96).

[99] 'English and US Law on Takeover Defences' (*Lawteacher*, 25 June 2019) <https://www.lawteacher.net/free-law-essays/business-law/english-and-us-law-on-takeover-defences-business-law-essay.php?vref=1> accessed 9 June 2021.

[100] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids [2004] OJ L 142.

[101] Marco Ventoruzzo, 'Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political Economic Ends' (2006) 41 Tex. Int'l L.J., Penn State Law 171 < http://elibrary.law.psu.edu/fac_works> accessed 9 June 2021.

[102] Dirk Van Gerven, *Common Legal Framework for Takeover Bids in Europe* (1st edn, Cambridge University Press 2008) 6.

With its implementation, takeover bids should be facilitated in order to encourage the single market and takeover activity within EU, and more efficient corporate landscape.[103] At the time of proposing, biggest takeover market in the EU was in the United Kingdom. That was the main reason why Takeover Directive has been modelled after the United Kingdom's City Code. Takeover Directive initially contained a mandatory provision to give the shareholders an exclusive decision–making power regarding the (hostile) bids and excluded the management (i.e., board neutrality rule), which was exactly the opposite to the United States' law.

The board neutrality rule, also known as a non-frustration or passivity rule, was one among the primary reasons as to why the Takeover Directive received such nefarious criticism at first. The Takeover Directive was later implemented in a different form, without the mandatory board neutrality rule, meaning that the EU Member States were give an option to opt out. Still, the board neutrality rule is considered to be the foundation of the European takeover regulation.[104] As presented and laid down in Article 9 of the Takeover Directive, it prohibits the management of a target company from taking any action which may result in the frustration of a takeover bid, without first obtaining the shareholder's approval.[105] Thus, in practice the target company cannot actually adopt any new defensive measure, i.e., poison pill.

Despite the influence of the City Code in relation to proposal of the Takeover Directive, it has, in contrast to the United Kingdom, resigned from the 'golden shares' practice. While those use to be frequently employed in many European countries and are still permitted in the United Kingdom, their use in the EU Member States today has declined due to the decisions of the Court of Justice of European Union, where it found that the use of such devices contradicts the basic principle of free capital circulation within the EU.[106]

[103] Paul Davies, Edmund-Philipp Schuster and Emilie van de Walle de Ghelck, 'The Takeover Directive as a Protectionist Tool?' (2010) ECGI - Law Working Paper No. 141/2010, 2 <https://ssrn.com/abstract=1554616> accessed 9 June 2021.
[104] James Tobias Whitlock, 'The Board Neutrality and Breakthrough Rules in Europe - A Case for Reform' (2014) Durham University, Master's Thesis, 51 <http://etheses.dur.ac.uk/10933/ > accessed 9 June 2021.
[105] ibid 2.
[106] Baker and others (n 13) 50.

Each European jurisdiction has its own characteristics and its own laws.[107] It is therefore perhaps unsurprising that the majority of EU Member States have elected to opt out of provisions stated in the Takeover Directive and some even strengthened their anti-takeover defences.[108] While several EU Member States do allow, at least in theory, the adoption of poison pills, some of them decided to choose a different approach. It has to be noted that most of them cannot adopt United States' style poison pills.[109] For example, German companies are generally able to adopt preventive measures, however these measures have to be in the interests of the company and must not harm it. Once the offer has been published by the bidder, the target company cannot use any measure that could hinder the success of the takeover.[110]

Furthermore, anti-takeover measures can be justified in certain situations under Dutch law. Such measures have to be necessary for the continuity of the target company and in the interest of the parties involved.[111] Lastly, probably the most interesting law regulation in regard to takeover defences stems from French law. Since the implementation of the Takeover Directive, French companies are not allowed to use poison pills as such. However, France devised a new form of takeover defence strategies, called offer warrants or *bons d'offre*. They can be issued by the shareholders of the target company, during the course of the hostile bid. They present a way to deter bidders from entering into a target company's capital.[112]

4.2.4. Japan

Japan, the land of the rising sun, has been an interesting and evolving case in the takeover sphere.[113] As a result of its unique culture, there has been a long debate whether Japan would *ever* adopt the hostile takeover defences. In contrast with the United States, hostile takeovers and takeover defences in Japan were non-existent for quite a long time.

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[107] Pietro Cavasola and others, 'Shareholder Activism: A European Perspective' (2017) CMS Corporate/M&A Publication, 4 <https://cms.law/en/chl/publication/shareholder-activism-a-european-perspective> accessed 9 June 2021.
[108] Hill (n 78) 6.
[109] Carsten Gerner-Beuerle, David Kershaw and Matteo Solinas, 'Is the board neutrality rule trivial? Amnesia about corporate law in European takeover regulation' (2011) 22/5 European Business Law Review, 30 <http://eprints.lse.ac.uk/39417/> accessed 9 June 2021.
[110] Cavasola and others (n 107) 44.
[111] Timmers (n 5) 22–23.
[112] Cavasola and others (n 107) 37.
[113] Hill (n 78) 7.

However, Japan's capital market, just like any other international market, was extensively altered in order to enhance flexibility of the corporate law.[114] All of that provided the basis for hostile takeover attempts and broadened the attention to the shareholders' interests. Compared to United States, where specifically the use of poison pills neither increased or decreased, a number of Japanese companies using them drastically increased from 2004 to 2007, when they were first introduced as an efficient defence mechanism.[115] Although Japan has far less foreign investments as other developed economies, the influence of Western countries led Japan to adapt certain corporate governance principles that were not present before.

Poison pills have proven to be an efficient defence and a functional addition to the corporate governance, Japan still stayed more cautious in regard to their specific practice and followed their traditionally closed model of corporate governance, although influential jurisdictions, specifically United States, have embraced the use of poison pills to the full extent.[116]

4.2.5. Australia

In contrast to other countries, Australia provides a unique approach with respect to the use of poison pills. Australia has implemented specific domestic laws which can be perceived as restrictive according to international standards.[117] The adoption of poison pills or any other defensive measure that would make the target company less attractive to a bidder in the event of a hostile takeover is generally forbidden under Australian takeover law. They are considered inconsistent with the target company's directors' duties to act in the best interest of the company and its shareholders.[118]

Disputes arising out of different takeover actions used to be decided by Australian courts. As a response to the growing issue of tactically initiating litigation procedures, Australian Takeovers Panel was created in order to specifically oversee the resolution of takeover disputes.

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[114] ibid.
[115] ibid 8.
[116] Ronald J Gilson, 'The Poison Pill in Japan: The Missing Infrastructure' (2004) Columbia Business Law Review, 4 <https://scholarship.law.columbia.edu/faculty_scholarship/1311> accessed 9 June 2021.
[117] Hill (n 78) 5.
[118] Mark Burger and others, 'Takeovers in Australia' (2018) DLA Piper, 9 <https://www.dlapiper.com/en/australia/insights/publications/2018/03/takeovers-in-australia/> accessed 9 June 2021.

A major innovation that was implemented by the Takeovers Panel was a new definition of a 'frustrating action' which deviates from the previous directors' fiduciary duty to the target company and its shareholders.[119] Frustrating action, an action adopted by the target company that breaches the offers requirements, now rather focuses on the effect of the directors' actions, instead on their purpose behind it and can only be undertaken if it is approved by the target company's shareholders.[120]

4.3. Effectiveness of Poison Pills

Having established the general framework and legal constraints of poison pill practice, it is of paramount importance to evaluate their effectiveness in different aspects. Their use has been a topic of a heated academic and practitioner's discussion for many years and when evaluating the effectiveness of poison pills, opposing arguments have to be considered.[121] While it is true that poison pills can be very effective in their purpose, they are often not the first line of defence.[122] That is due to the fact that, if employed incorrectly, they can greatly weaken the target company and do not necessarily prevent or reduce the probability of the takeover if the bidder is tenacious.[123] Therefore, if not combined with other defences, implementation of poison pills itself is not always the most comprehensive strategy to fend off a determined bidder.[124]

As previously discussed, poison pills serve as a medium for resisting bidders and possible takeovers. Irrespective of their possible limitations, they are still one of the most sought after and practiced defence strategies. Each poison pill typically has a binary purpose. Usually, the primary purpose is averting the bidder and subsequently if unsuccessful, to increase the bidding amount.[125] Although, in some cases the only goal may be to increase the later and to positively impact the value of shareholders' assets. It follows that there are two crucial arguments in favour of views that support poison pills' benefits, that have to be taken into consideration when evaluating their effectiveness.

[119] Hill (n 78) 5.
[120] Burger and others (n 118) 9.
[121] Baker and others (n 13) 49.
[122] Zarin and Yang (n 17) 18.
[123] Chawla (n 4) 27.
[124] Chawla (n 4) 28.
[125] Sunder (n 2) 49.

First, poison pills can protect existing shareholders of the target company from hostile offers and second, they allow the target company to issue an alternative to the bidder's initial offer to its shareholders. There are certain aspects that can only be adequately analysed through empirical case study. Additionally, certain topics and specifics are in need of individual assessment in order to highlight important aspects and evaluate their impact in relation to issues presented by implementation of poison pills.

4.3.1. Empirical Case Studies

Having covered the common concerns and different (approaches) impacts regarding the effectiveness of poison pills, it is important to establish their effectiveness in practice as well. While theoretical approach is very important, it is crucial to analyse the implementation of poison pills in practice where their true nature comes to light. This section shall focus on the empirical side of the effectiveness of poison pills. Main outline of this section is to cover various cases that highlight above mentioned concerns arising out of the theory (how effective are poison pills) through different, specific cases. It is important to weigh their effectiveness on a case-by-case basis and take into the account the interplay between differing situations and implementation of poison pills. When referring to the takeover battles, the Delaware's Courts issued the highest number of opinions in the field of mergers and acquisitions.[126] Early case law practice emphasized that poison pills must be reasonable in relation to the received offer, subject to the condition that the offer inadequate and coercive.[127] It later developed to the point where it *finally* allowed the target company's management to use the poison pill as a strategy against hostile offers that posed a legitimate threat to the company.[128]

4.3.1.1. Air Products v Airgas

This study follows the takeover process of one of the most significant enduring battles for corporate control in the history of Delaware's jurisprudence, *Air Products v. Airgas* (hereinafter: Airgas case).[129]

[126] Andrew Zwecker, 'The EU Takeover Directive: Eight Years Later, Implementation but Still no Harmonization among Member States on Acceptable Takeover Defenses' (2012) 21 Tul J Int'l & Comp L 238.
[127] Velasco, 'The Enduring Illegitimacy of the Poison Pill' (n 76) 386.
[128] ibid.
[129] *Air Products and Chemicals, Inc. v. Airgas, Inc*. 16 A.3d 48 (Del. 2011).

The decision that resulted from the struggle between two competitors in the industrial gas business, Air Products and Chemicals, Inc. (hereinafter: Air Products) and Airgas, Inc. (hereinafter: Airgas), highlighted one of the central corporate governance concerns – at what point should the target company's board allow its shareholders to make a decision whether an offer legitimately values their shares in the company?[130] To put it simply, the case posed a question of the allocation of the power between managers and/or directors and existing shareholders in a hostile tender offer – who decides when and if the company should be sold?[131]

The takeover saga began when Air Products started privately pursuing a possible acquisition or merger with Airgas in the fall of 2009. Before making its offer public, Air Products initially proposed an all-stock transaction to Airgas, with the amount of $60 per share, which was later increased to an offer of $62 per share in a combination of stock and cash. To oppose the takeover attempt, Airgas adopted a poison pill to place the company's share price higher than Air Products wanted to pay, and rejected every proposed offer. Their reactions lead to the point where Air Products decided to launch a hostile public tender offer to acquire all outstanding Airgas shares at $60 per share. However, that offer was increased three times in the span of twelve months, until it reached the final offer of $70 per share.[132] All of those offers came along with a condition to redeem the poison pill, however, each bid was, again, consistently rejected by the Airgas's board of directors as "clearly inadequate" and perceived as undervaluing the company.[133] In addition to the adopted poison pill strategy, Airgas also had a staggered board[134] in place, which was seized after by Air Products as a part of its takeover attempt. Air Products tried to seize control of Airgas's staggered board by nominating three candidates at Airgas's annual meeting, which all three were elected on Airgas board.[135]

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[130] Samuel R Snider, Erik L Belenky and Brooke E Russ, 'Poison Pill Takeover Defense in Air Products & Chemicals, Inc. v. Airgas, Inc.' (*Lexis Nexis*, 29 July 2011) <https://www.lexisnexis.com/legalnewsroom/corporate/b/blog/posts/poison-pill-takeover-defense-in-air-products-amp-chemicals-inc-v-airgas-inc> accessed 9 June 2021.

[131] Paul S Ware, 'Air Products & Chemicals, Inc. v. Airgas, Inc. Just Say Wait' (2011) 26/1 LJN The Corporate Counselor, 1 <https://www.bradley.com/-/media/files/insights/publications/2011/05/air-products--chemicals-inc-v-airgas-inc/files/reprint/fileattachment/paul-ware-alm-article.pdf> accessed 9 June 2021.

[132] ibid.

[133] Steven Davidoff Solomon, 'A Case Study: Air Products v. Airgas and the Value of Strategic Judicial Decision-Making' (2012) Columbia Business Law Review, 18 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1982199> accessed 9 June 2021.

[134] Staggered or classified board describes the way in which the boards of directors are elected. Elections divide the company's directors into a number of different groups, where only one group is re-elected each year.

[135] Ware (n 131) 1.

However, their attempt was unsuccessful, because the newly elected Airgas' board, including Air Products' nominees, concluded that the latest offer was, in fact, inadequate. As a result, the board unanimously rejected the offer and refused to redeem the adopted poison pill.[136] The Delaware's Court upheld the Airgas' poison pill, stating that the board had the power to defeat correctly identified insufficient hostile offer and that the adopted defensive measures were within the scope of reasonable responses proportionate to the threat.[137]

4.3.1.2. Oracle v Peoplesoft

Another equally interesting takeover battle and a staple in business law was the result in *Oracle v. PeopleSoft* case.[138] This example follows two companies based in the United States, Oracle and PeopleSoft, which competed in the enterprise application software business. The year and a half long battle started when Oracle launched its first hostile bid in 2003. The acquisition culminated afterwards and resulted in a long, aggressive takeover battle.[139] Oracle announced unsolicited cash tender offer to PeopleSoft at $16 per share, which was below the average trading price.[140] Oracle's bid raised a number of difficult questions for the target company's board of directors, whether their products would stay supported after the awaiting takeover.

However, Oracle's sole aim of acquiring the PeopleSoft was to extend its business and have a bigger market share. PeopleSoft's board of directors was therefore faced with a decision on how to respond to the bid and to the uncertainty it had created.[141] They stated at the very beginning of the takeover process, that they will fight against Oracle in order to remain an independent company. The PeopleSoft's board of directors has been repeatably declining every (increased) bid that Oracle has offered and advised its shareholders to follow.[142] Accordingly, they engaged in a number of anti-takeover actions, among which the poison pill, enacted in company's corporate bylaws, was the most effective one/played the most important role.[143]

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[136] Solomon (n 133) 4.
[137] Ware (n 131) 1.
[138] *Oracle v. PeopleSoft*, 20377 (Del. Ch. 2004).
[139] Baker and others (n 13) 343.
[140] ibid.
[141] Jennifer Arlen, 'Regulating Post-Bid Embedded Defenses: Lessons from Oracle versus PeopleSoft' (2006) Harvard Law and Economics Discussion Paper No. 561, 17 <http://dx.doi.org/10.2139/ssrn.921833> accessed 9 June 2021.
[142] David Millstone and Guhan Subramanian, 'Oracle v. PeopleSoft: A Case Study' (2007) 12 Harv. Negot. L. Rev. 1 <http://nrs.harvard.edu/urn-3:HUL.InstRepos:11352714> accessed 9 June 2021.
[143] Baker and others (n 13) 49.

They actually had two poison pills instituted. First was already adopted in 1995 in company's bylaws and it allowed the existing shareholders to purchase the company's stock at half price, if a hostile bidder would acquire 20 percent of the stock. Second, the Customer Assurance Plan (hereinafter: CAP) was adopted exactly as a defence against Oracle's takeover attempt. CAP guaranteed to pay back PeopleSoft's customers in the event of a takeover, in order to make the takeover expensive for Oracle. Both defence strategies were litigated by Oracle, claiming that they must be redeemed. However, before the Delaware's Court of Chancery could decide on its judgement, PeopleSoft surrendered. The takeover battle went on for approximately a year and a half, before PeopleSoft accepted $26.50 per share, which at the time meant 66 percent more than $16 from initial offer.[144]

4.3.1.3. Third Point v Ruprecht

Another example of how effective a poison pill can be, is the case *Third Point LLC v. Ruprecht*,[145] where it was adopted to prevent a creeping takeover.[146] The takeover started when three activist hedge funds, Third Point, Marcato Capital Management and Trian Fund Management, acquired a substantial amount of Sotheby's shares, global art business, which primarily acts as an agent for high-end art sales and it operates the oldest auction house in the world.[147] Early in 2013, Third Point publicly disclosed that it had acquired 500.000 Sotheby's shares, which at the time meant approximately 9.4 percent of all shares. Additionally, the three activist hedge funds had a collective ownership of approximately 19 percent of the Sotheby's outstanding shares, which were accumulate without paying a control premium.[148] As a response to the threats posed by increasing hedge fund activity, Sotheby's board unanimously adopted a two-tier structured poison pill, which would be triggered if passive investors acquired 20

[144] Raju Choudhary, 'Poison Pill Defence Strategy' (*CA Knowledge*, 2 November 2020) <https://caknowledge.com/poison-pill-defence-strategy/> accessed 9 June 2021.
[145] *Third Point LLC v. Ruprecht et al.,* C.A. No. 9469-VCP (Del. Ch. 2014).
[146] A creeping takeover is an accumulation of the target company's shares, by gradually purchasing them at the current market price, rather than making a premium offer to its shareholders.
[147] Practical Law Corporate & Securities, 'Third Point v. Ruprecht: Creeping Control and Negative Control Upheld as Defenses for Two-tier Poison Pill' (*Thomson Reuters Practical Law*, 8 May 2014) <https://content.next.westlaw.com/4-567-6928?__lrTS=20210405112216064&transitionType=Default&contextData=(sc.Default)&firstPage=true> accessed 9 June 2021.
[148] Activist hedge funds regularly engage in intrusive actions in order to implement their profit-improving plans. They perceive the targeted companies as a tool of realizing such plans, rather than seeking control in target companies. *See* Brav and others, 'Hedge Fund Activism, Corporate Governance, and Firm Performance' (2008) FDIC Center for Financial Research, Working Paper No. 2008-06, 5 <https://www.fdic.gov/analysis/cfr/2008/wp2008/2008-06.pdf> accessed 9 June 2021.

percent interest of the company, and if active investors acquired 10 percent ownership threshold.[149] The adopted poison pill additionally contained an exception applying only to qualifying offers, which, if proposed, would not trigger the pill. The case at hand therefore arose from the Sotheby's alleged misuse of its poison pill – Third Point claimed that the Sotheby's violated its fiduciary duties when it engaged in such defence strategy, however their claims were refused by Delaware Court of Chancery.[150] It ruled that the Third Point did not have a reasonable possibility of succeeding on its substantive claims and further stated that the Sotheby's response to the threat was rational and corresponding with the threat posed by the Third Point and other shareholders.[151]

4.3.1.4. Conclusions on the Case Studies

From the specific case analysis, it can be concluded that poison pills are effective as a defence strategy against takeovers and they additionally increase the bidder's offers and shareholders value. However, they are not always fully effective in regard to averting the takeovers. If the takeover should still occur, adopted poison pills act as an effective defence strategy that can help to increase the shareholders' value. One example of that was the case of *Oracle*, where although the adoption of poison pill did not prevent a takeover, its use proved to be effective since it showed how beneficial it can be by securing the increase in the value of shareholders' assets. Impact of implementation of poison pills therefore can be measured through the comparison of the values of shareholders' assets before and after the takeover. This outcome is most evident in instances where the shareholders and the management of the target company continuously decline bidder's offers while at the same time bidder is not relenting in its attempts to acquire the company. On the other hand, it is precisely in these circumstances that a poison pill is not sufficient enough to hold off a determined bidder who is willing to acquire a company by any means necessary.

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[149] Sullivan and Cromwell, 'Third Point LLC v. Ruprecht: Delaware Court of Chancery Finds Board's Use of Rights Plan Reasonable Based on Creeping Takeover and Effective Negative Control Threats Created by Activist Shareholder' (2014) Sullivan and Cromwell LPP, 1 <https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Third_Point_LLC_v_Ruprecht.pdf> accessed 9 June 2021.
[150] Third Point (n 145).
[151] Latham and Watkins, 'Third Point LLC v. Ruprecht — Activism Confronts the Rights Plan' (*M&A Client Alert,* May 2014) <https://www.lw.com/thoughtLeadership/lw-sothebys-delaware-poison-pill-decision> accessed 9 June 2021.

Airgas contemplates adoption of combination of two takeover defences – staggered boards and poison pills, which will be addressed more comprehensively in the following chapters. It is important to note that court reasoned that a managing board of the target company can implement different mechanisms of defence and deflection against the hostile takeovers. It was highlighted that said mechanisms must be reasonable and proportionate with regard to the oncoming threat. It can be concluded that implementation of a poison pill has positive effects on the company as well as the managing board and shareholders as long as it is utilised appropriately and with legitimate intentions. The same conclusion can be drawn for the *Third Point* where the previous reasoning was further confirmed.

Finally, sometimes the primary goal can be achieved and bidder is dissuaded from its takeover attempt. However, since the amount of the shares of the target company has grown it can remain questionable how successful the defence and the implementation of the poison pill truly was. While the takeover is repelled the value of the company can be drastically lowered and the defence mechanisms would carry adverse effect. Potential risks of the implementation of the poison pills shall be discussed in detail in the following chapters.

4.3.2. The Impact on Shareholder's Value

Majority of the poison pill controversy revolves around the question of impact they may have on the shareholders of the target company, being either harmful or beneficial.[152] Poison pills can affect the target company and its shareholders in many ways; thus, a significant amount of research has been concluded on the effect that poison pills have on the shareholders' value. While they can be adopted by the management, without prior consultation to the shareholders in the United States, other countries and jurisdictions, only allow for poison pills to be passed upon the shareholders vote of ratification.[153] The fact that there is no requirement for prior approval within United States has created some concerns, whether the management and boards of directors are acting in the best interest of the shareholders, or whether merely protecting their own profits and positions. Consequently, two contrasting approaches have evolved.

[152] Bruner (n 65) 17.
[153] Baker and others (n 13) 50.

On one hand, poison pills serve as a medium to protect incompetent managing boards. The decision is merely in the hands of directors and management, as shareholders are excluded and that causes the fear for management entrenchment.[154]

According to this approach, the implementation of a poison pill provision is likely to have a negative impact on the target company's shares and stock prices, and the shareholders' wealth, which is usually reduced after the adoption of a poison pill.[155] On the other hand, that poison pills are adopted in the interest of shareholders. This approach defines antitakeover provisions, and poison pills in particular, as rational mechanisms that do protect shareholders.[156] This approach assumes that the power of adopted poison pill lies within their power to reject undesirable bids. That is predicted to be in the long-term of the target company's shareholders as its management will act in their interest and only adopt the poison pill in order to negotiate a higher price and thus more value.[157] Within this approach there are two independent arguments in support of it. Firstly, that the adoption of a poison pill puts the target company and its executives in a superior bargaining position. Secondly, that a poison pills helps the target company and its executives to obtain the maximum premium of the offered bid.

The main argument in the support of the poison pill and the shareholder's interest hypothesis is based on the amount of leverage that the adoption of a poison pill provides to the target company and its management.[158] Once a poison pill is adopted, the target company is put in a better position where it can decide whether and under what circumstances it should, if even, be taken over.[159] Poison pill therefore empowers the incumbent management to bargain more effectively and it increases the power of the target company, resulting a higher price from the bidder.[160] That makes a non-negotiated, hostile takeover extremely difficult and more expensive for the bidder. Consequently, poison pills are related to higher takeover premiums.[161]

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[154] Laura Bothmer, 'The effect of Poison Pills on Shareholder Value' (2018) Erasmus University Rotterdam, Master's Thesis, 3 <https://thesis.eur.nl/pub/43147/Bothmer-L.E.-410351-.pdf> accessed 9 June 2021.
[155] ibid 5.
[156] Simon Hitzelberger, 'What effect do poison pills have on shareholder value? An empirical research on the adoption of poison pills' (2017) NOVA – School of Business and Economics, 4 <https://run.unl.pt/bitstream/10362/26192/1/Hitzelberger_2017.pdf> accessed 9 June 2021.
[157] ibid 37.
[158] Sunder (n 2) 50.
[159] ibid.
[160] Bruner (n 65) 17.
[161] ibid.

As mentioned above, majority of takeovers are friendly when started and bidders in most cases resort to a hostile bid if they cannot negotiate a friendly takeover.[162] Therefore, increases in prices can be expected in both, hostile and friendly takeovers. Although the superior bargaining position and power argument is very attractive, it is also flawed.[163]

While the given leverage of the target company may force the bidder to increase its offer when facing target company's defiance, there is a threshold which the bidder will not cross.[164] It is therefore important to keep in mind that increased premiums come at the expense of reducing the probability for a successful takeover, which can ultimately put shareholders of the target company in a precarious position. While the fact that bidders have been dissuaded from the finalising of the takeover might appear as a victory for the target company, that does not mean that the shareholders will be left in a better position afterwards – due to the poison pill's adoption their value will decrease and there will be no bidder to offer them a premium.

4.3.3. How Much is Too Much?

It was established that poison pills are an effective defence strategy against hostile takeovers, whether they avert the bidder and consequently the takeover attempt, or raise the shareholders' value. However, if they are implemented either incorrectly or in *bad faith*, their consequences can have extremely negative impact and sometimes cause irreparable damage to the target company and its shareholders. With the *original* poison pill timely evolution, target companies additionally started to testing its boundaries with some extreme types. To elaborate on that, a description of two arsenal poison pill types is in place.

4.3.3.1. Suicide Pills and Scorched Earth Defence

When evaluating effect of any type of poison pill, suicide pills, as can already be concluded from the name itself, are a radical, extreme version of poison pills, also known as Jonestown defence.[165] The term 'Jonestown defence' refers to the 1987 mass suicide of the pseudo-religious organization People's Temple in Guyana.[166]

[162] Schwert (n 26) 2600.
[163] Sunder (n 2) 53.
[164] ibid.
[165] Gorzala (n 19) 24.
[166] Baker and others (n 13) 347.

In economic sense, such defence focuses on a quick and drastic reduction of the target company's value.[167] In order to thwart the hostile bid, the target company engages in tactics that ultimately threaten its existence. The goal behind the suicide pill is to immediately destroy the target company in order to make it as unappealing as possible to the bidder.[168] To reach that goal, the target company strips all of its important assets, employees and cash – it commits a corporate equivalent of suicide. The suicide pill strategy is economically questionable because the company deliberately destroys corporate value at the sole cost to shareholders. They lose not only their anticipated takeover premium but also the initial value of their share before the bidder's offer.[169]

Another strategy, often associated with the suicide pill, is the Scorched Earth Defence strategy. It is named after the guerrilla warfare tactic of destroying anything that could potentially be useful to an enemy.[170] It takes the same form in the business world – a company that is on the verge of a takeover does everything within its power to make itself less attractive to hostile bidders.[171] For this to happen, the target company is usually willing to sell off assets, as well as engage debt, which would have negative impact on any bidder's investment. In some cases, the Scorched Earth Defence might reach the point of a suicide pill.[172]

4.3.3.2. Dead–Hand Poison Pills

Same as poison pills, Dead–Hand pills can be adopted and implemented by the target company's board of directors and management, and can be deactivated by the same procedure as well.[173] Bidders usually try to exploit that feature for their own benefit and circumvent the adopted poison pill by initiating a tender offer and offering a higher premium, that would put pressure on the target company's board in order to remove the poison pill.[174]

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[167] Gorzala (n 19) 24.
[168] Jason Gordon, 'Scorched Earth Policy' (*The Business Professor*, 16 December 2020) <https://thebusinessprofessor.com/business-governance/scorched-earth-policy-definition> accessed 9 June 2021.
[169] Baker and others (n 13) 347.
[170] Daniel Liberto, 'Scorched Earth Policy' (*Investopedia,* 6 February 2021) <https://www.investopedia.com/terms/s/scorchedearthpolicy.asp> accessed 9 June 2021.
[171] ibid.
[172] Gordon (n 168).
[173] Klausner (n 56) 1350.
[174] Marion Pouchain, 'Which antitakeover defences are really efficient?' (2014) HEC Paris, Master's Thesis, 1 <http://www.vernimmen.com//ftp/20140609_Master_Thesis_Marion_Pouchain.pdf> accessed 9 June 2021.

Where most of the time there is nothing wrong with the removal of a defence and allowing for takeover to complete, the problem can occur if too much power is given in the wrong hands. That is the case with the *dead hand* poison pills. Dead hand provision was actually the first attempt of evolution away from the *original* poison pill provision, trying to counteract the effects of a hostile bid. Dead–Hand provisions allow and give the power to subsequently redeem a poison pill only to those directors that were on the target company's management board at the time of a poison pill adoption.[175] Such power is preserved even in the event if all these directors are subsequently voted out, they may still control continuation of the poison pill. Thus, two classes of directors are created and a consequence of such provision is basically to endure the incumbent directors as they are the only ones who could redeem the poison pill. Consequently, it is not surprising that many legislatures and courts, including Delaware, have shown a willingness to disallow and outlaw them.[176]

4.4. Disadvantages and Risks Associated with the Adoption of Poison Pills

Although poison pills may effectively block certain undesirable offers, it must be recognized that its adoption is neither risk free nor it is guaranteed that it will carry beneficial effects.[177] While in most cases the adoption of a poison pill does provide a number of benefits to corporations as well as existing shareholders, not every poison pill will always lead to the best possible outcome or even that there are no risks associated with its adoption. When it comes to potential risks, potential disadvantages to poison pills do in fact exist and should be closely examined.

First and perhaps the most problematic issue, lies within the dilution of the stocks and shareholder's value. When the target company issues a number of new shares and existing shareholders purchase them at a discount, the value of the company drops and adversely impacts the shareholder's value.[178] This effectively means that existing shareholders have to obtain new shares, just to maintain their prior ownership.

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[175] Grieco (n 85) 631.
[176] See, e.g., *Bank of New York Co. v. Irving Bank Corp*, 528 N.Y.S.2d 482 (N.Y. Sup. Ct. 1988); *Carmody v. Toll Bros., Inc*., 723 A. 2d 1180 (Del Ch. 1988).
[177] Dawson (n 66) 426.
[178] Sanjay Bulaki Borad, 'Poison Pill: Meaning, Pros & Cons, Types, Examples, and More' (*Finance Management,* 3 December 2020) <https://efinancemanagement.com/mergers-and-acquisitions/poison-pill#Disadvantages_of_the_Poison_Pill> accessed 9 June 2021.

Inversely, hostile bidders are *forced* to acquire more shares. While that can consequently prevent the takeover and on one hand present a win for the target company, it can on the other deprive shareholders of any potential revenue that might arose from the successful takeover.[179] Usually this is a result of a weak management, as hinted above. The target company is affected when management board is not strong, which makes it vulnerable and an *easy* takeover target.[180] The takeover market acts as a *last resort,* which cannot be realized if the poison pill is adopted. That stems from the fact that poison pills tend to protect ineffective managing boards. The bidder typically realizes that the target company has (strong) potential to improve if managed properly. As a result, poison pills are implemented by management to protect themselves and ultimately to deprive investors of a better management.[181]

As it was previously pointed out, poison pills in particular transfer the power to consider unsolicited tender offers. Thus, there is a common risk of management entrenching itself, instead of operating in the interest of the shareholders.[182] For that reason empirical research questions the benefits and effectiveness of poison pills, since the given power can be abused by the target company's management.[183] That is supported by empirical evidence which suggests minor decreases in the stock's value, once the poison pill adoption is announced. Active market often views poison pills as a mechanism for entrenchment rather than optimal contracting. That can have a negative impact on the motivation of potential institutional investors, who could *save* a certain company. They are therefore discouraged from investing into corporations that have aggressive defences.[184] At this point it can be concluded that the adoption of poison pills has many great advantages, since it can help the target company to either raise its value, negotiate a higher bid premium, and avert the hostile takeover attempt. However, there are also certain risks, disadvantages and negative impacts that have to be considered, if they are not used properly and in the interest of the target company.

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[179] Kalen Smith, 'How Companies Use Shareholder Rights Plans (Poison Pills) to Fight Hostile Takeovers' (*Money Crashers*, 6 July 2011) <https://www.moneycrashers.com/poison-pills-fight-hostile-takeovers/> accessed 9 June 2021.
[180] DePamphilis (n 1) 98.
[181] Smith (n 179).
[182] Hitzelberger (n 156) 6.
[183] Randal A Heron and Erik Lie, 'On the Use of Poison Pills and Defensive Payouts by Takeover Targets' (2006) 79/4 Journal of Business <https://www.biz.uiowa.edu/faculty/elie/Pills.pdf> accessed 9 June 2021, 1786.
[184] Adam Hayes, 'Poison Pill' (*Investopedia*, 4 May 2021) <https://www.investopedia.com/terms/p/poisonpill.asp> accessed 9 June 2021.

4.5. Selected Defence Strategies

Within the section 3.1., takeover defences were already discussed in a general sense. However, throughout the thesis it was contemplated that although poison pills are effective, they are often not the only or the first line of defence strategy used against takeovers. Target companies usually use more than only one defence in order to avert and slow down the hostile takeover. That further means that it is more likely that the takeover will actually be averted. This section will focus on analysis of other takeover defences, pre- and post-offer, that are often used in order to complement the implementation of poison pills. Main focus will be given to shark repellents.

4.5.1. Shark Repellents

Another group of pre-offer defence strategies are shark repellents. They refer to a number of measures, employed by the target company in the event of a hostile takeover. Shark repellents can be achieved by either periodically or continuously amending the company's bylaws, which become active when a takeover attempt is made publicly to the target company's shareholders and management.[185] They precede poison pills as a defence against takeovers, however their effectiveness of slowing and averting takeover attempts has been mixed. However, they have now mostly became important alternatives and supplements to poison pills.[186] Their first role is to make it harder to gain control of the company and to consequently fend off unwanted bidders. The aim behind shark repellents and amending the company's bylaws it to restrict the transfer of control by amending target company's voting practices. [187] When utilized in practice, they require the shareholders vote because their adoption calls for amendments of the company's charter and/or bylaws, contrary to the poison pills, which generally do not require shareholders' approval. To counter hostile and unwelcomed takeovers, companies can choose off from several different shark repellent measures, that either strengthen the board's defences or limit the shareholders' actions. Although, most frequently and commonly used ones among the variety are staggered boards, supermajority provisions, golden parachutes and anti-greenmail provisions.[188]

[185] Gorzala (n 19) 13.
[186] DePamphilis (n 1) 113.
[187] Brunner (n 63) 25.
[188] Gorzala (n 19) 13–15.

4.5.2. Staggered Boards

Default legal rule in most jurisdictions is that the target company boards' directors are elected by shareholders and usually perform on one-year terms. However, some companies often decide to enforce different, alternative strategies and mechanisms to elect its directors, known as staggered or classified boards. The term describes the manner in which the directors are elected.[189] Elections are held in a way that they divide the company's directors into a number of different groups, usually three. Consequently, only one group is up for re-election each year, which means that directors are elected fractionally. That makes it more complicated for the bidder to gain control over the target company, as the existing board cannot be immediately and fully replaced at once.[190] Therefore, if a staggered board is in place, a hostile bidder cannot replace the board, regardless of the number of votes held.

In the process against the hostile takeover, the target company can adopt more than only one defence mechanism in order to avert the attempt and to strengthen its board. Whilst it was substantiated that poison pills usually are 'effective enough' on their own, the target company may sometimes supplement the swallowed pill and raise its potency with combining it with other anti-takeover defence mechanisms, most commonly with staggered boards. [191] The pair complements each other very effectively and therefore makes a potent combination as a takeover defence strategy. Poison pills are effective and limit the bidder's power and capability to acquire the target company's shares, however their protection is relatively weak, if the target company is exposed to a rapid proxy fight.[192] A staggered board without a poison pill is similarly inefficient, considering the fact that the target company's directors will no longer continue to resist the takeover, if the bidder already acquired the majority of the target company's shares.[193] In an event of a hostile takeover, adopted poison pill will therefore limit the bidder's capability to gain control over the target company, and consequently force the bidder to initiate a proxy fight.

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[189] Pouchain (n 174) 21.
[190] Gorzala (n 19) 15.
[191] The Delaware's Courts have allowed the target company's directors to utilize the effects of poison pills with combination of other corporate measures. See, e.g., *Versata Enters., Inc. v. Selectica, Inc.,* 5 A.3d 586, 604 (Del. 2010); *Air Products and Chemicals, Inc. v. Airgas, Inc*. 16 A.3d 48 (Del. 2011).
[192] *See* above, section 3.1.
[193] Lucian Bebchuk, John Coates and Guhan Subramanian, 'The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy' (2002) Harvard Law School, Discussion Paper No. 353, 11 <http://www.law.harvard.edu/programs/olin_center/papers/pdf/353.pdf> accessed 9 June 2021.

With the staggered board provision in place, the bidder will virtually have to pursue two proxy fights in order to gain the anticipated control, since only one classified group of directors is elected each year.[194] Hence, the poison pill paired with a staggered board is considered one of the most powerful anti-takeover defences.[195] The poison pill–staggered board combination can present a thorn in the bidder's flesh. The 'combination issue', if even can be perceived as an issue, has already been the subject of litigations and a popular debate topic. One of the opening questions in disputes that involve companies with both implemented mechanisms, is whether these mechanisms should be viewed as a combined under Unocal test, or independent response to opposed threats.[196]

Before discussing the judicial response, it is necessary to note that due to the fact that poison pills are less common and/or restricted in jurisdictions other than United States. Analysis below will accordingly focus and derive from Delaware's corporate law practice. When reasoning whether a staggered board and poison pill (if adopted together) have to be taken as a whole or review independently, the effect and the purpose behind the implementation have to be considered.[197] Delaware's Court allowed the combination in the *Airgas case*, a widely observed landmark decision.[198] Its decision could have had a much simpler solution, if Delaware's Court would follow the independent approach. Prior to the *Airgas case,* the combination issue was already brought in front of the Delaware courts in the *eBay v. Newmark* (hereinafter: eBay)[199] and *Versata v. Selectica* (hereinafter: Selectica),[200] where contrasting approach was taken.

The eBay's board of directors adopted a staggered board, accompanied with issuance of the new shares, all in the same day. In order for both measures to be examined collectively under the Unocal test, defensive actions should be inevitably related. Despite the fact that eBay's board of directors adopted both mechanisms in the same day, which might have been viewed as a unified response, the Delaware Court of Chancery did not find them inseparably related.[201]

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[194] Grieco (n 85) 634.
[195] Yakov Amihud, Markus Schmid and Steven D Solomon, 'Settling the Staggered Board Debate' (2018) 166 U. Pa. L. Rev., 1481 <https://scholarship.law.upenn.edu/penn_law_review/vol166/iss6/3/> accessed 9 June 2021.
[196] Grieco (n 85) 634.
[197] ibid 635.
[198] Ashby Jones, Delaware Speaks: Airgas and Its Poison Pill Prevail Over Air Products (*Wall Street Law Journal Blog*, 15 February 2011) <https://www.wsj.com/articles/BL-LB-39262?reflink=desktopwebshare_permalink> accessed 9 June 2021.
[199] *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010).
[200] *Versata Enters., Inc. v. Selectica, Inc.,* 5 A.3d 586 (Del. 2010).
[201] Grieco (n 85) 635.

In circumstances of the case at hand the court concluded that the staggering did not present a defensive response, since the board of directors did not gain any further control with this action taken. Meanwhile, the Delaware Court of Chancery seen the adopted poison pill as clearly defensive measure and therefore reviewed it separately.[202] The same approach was taken in the *Selectica*, where staggered board provisions were recognized as an anti–takeover defence measure, but noted that they can also be adopted for other business purposes. It was for that reason decided that although the combination of both measures makes it difficult for the bidder to obtain control over the target company, that does not automatically constitute a preclusive defence.[203]

4.5.3. Supermajority Provisions

Target company can avoid hostile takeover attempts by launching different means of defences. However, sometimes a situation can occur where the bidder already holds a certain number of shares and controls the managing board in its target company. As it was previously indicated, the existing shareholders and managers of the target company can adopt certain provisions in its bylaws in order to can reinforce its control and power by limiting shareholders' actions, in order to deter an unwelcomed takeover. These restrictions can encompass shareholders' ability to engage in consent solicitations and use of supermajority rules.[204]

Supermajority provisions are related to specific decisions, such as mergers and director selection. In most jurisdictions these provisions usually require a minimum shareholders' approval of at least two thirds of voting shares for certain decisions. Nevertheless, with supermajority provision adopted, a higher percentage of shares is needed to approve a merger, and it is usually around 80 percent.[205] Since the definition of supermajority is different in every national jurisdiction, the threshold varies from one country to another, but it is never below 51 percent. Thus, the requirements in supermajority provisions can help to avert a hostile takeover attempt by blocking the bidder. It follows that supermajority provisions intend to empower and protect minority shareholders, so they can express their interests in the case of a strong attack against their company.[206]

[202] eBay (n 199) 36.
[203] Grieco (n 85) 635.
[204] DePamphilis (n 1) 114.
[205] Auerbach (n 61) 58.
[206] Gorzala (n 19) 15.

4.5.4. Golden Parachutes

Another commonly used shark repellent in hostile takeover cases are golden parachutes. Golden parachutes consist of employee severance packages, which are triggered when a change in control occurs.[207] They are often referred to as a compensation, lucrative severance packages, to the target company's senior managers, who are terminated as a result of a takeover. They present a special agreement, contract between the target company and its executives, that they will be *rewarded* with substantial benefits (which can be in form of stock options, cash bonuses and severance pays) in the event of a hostile takeover. Accordingly, golden parachutes are used as an anti-takeover measure that raises the cost of a takeover for a hostile bidder. However, in line with a picturesque name they carry, golden parachutes can occasionally seem truly made of gold and instead of breaking the fall all of the weight of gold can sometimes only accelerate the downfall.

Golden parachutes are not ethical or unethical per se, but they depend on several factors.[208] It is on one hand asserted that they are destroying shareholder's value and have a damaging impact on their interests, as they increase the costs of takeovers by improperly altering the wealth to unworthy managers.[209] As the target company's senior managers implement golden parachutes to protect themselves, they can go even further with their actions. They can give certain benefits to inferior executives as a poison pill to make the company unappealing to the bidder.[210] On the other hand, it is claimed that, if constructed properly, golden parachutes have beneficial effect on the target company and its shareholders' wealth, as they reduce conflict of interest between shareholders and managers, and thus facilitate a successful takeover.[211]

4.5.5. Anti–Greenmail Provisions

Before tackling the topic of anti-greenmail provisions, it is crucial to first establish what Greenmail is. It refers to the situation when the target company's management repurchases its own shares that are held by a substantial shareholder or bidder.

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[207] DePamphilis (n 1) 222.
[208] Baker and others (n 13) 80.
[209] Hyuk Choe, Judith C Machlin and James A Miles, 'The Effects of Golden Parachutes on Takeover Activity' (1993) 36 Journal of Law and Economics, The University of Chicago, 861 <https://www.journals.uchicago.edu/doi/pdf/10.1086/467300> accessed 9 June 2021.
[210] Baker and others (n 13) 80.
[211] Choe, Machlin and Miles (n 209) 861.

This transaction often occurs if a large shareholder presents a threat of takeover. In exchange for a premium, above–market price, the paid shareholder agrees to refrain from any hostile takeover activity.[212]

Such measures often lead to questions of ethical issues specifically, if the target company's management breaches its fiduciary duties to their other shareholders, by pursuing self-interests.[213] Drawing from that, greenmail payments can serve as a management entrenchment mechanism. To prevent such situations, anti-greenmail provisions were invented. Respectively, anti-greenmail provisions are those provisions and amendments to company's bylaws, which prohibit payment of the greenmail to the target company's managers, unless the offer is made to all shareholders or if all shareholders approve this type of transaction.[214]

[212] James M Mahoney, Chamu Sundaramurthy and Joseph T Mahoney, 'The Differential Impact on Stockholder Wealth of Various Antitakeover Provisions' (1996) 17/6 Managerial and Decision Economics, 540–41 <https://www.jstor.org/stable/2487949> accessed 9 June 2021.
[213] Baker and others (n 13) 79.
[214] Mahoney, Sundaramurthy and Mahoney (n 212) 540.

5. CONCLUSION

"Sola dosis facit venenum"

All things are poison and nothing is without poison; only the dose makes a thing not a poison.

— Paracelsus

In the analysis of case law and theory there is a reoccurring theme associated with the poison pills – consideration of the scope of their effectiveness as a defence mechanism. It is undeniable that poison pills are perceived as an effective measure, regardless of the implications their name carries. There is a thin line between a poison and a remedy – when administered appropriately remedy achieves desired effect, however, when implementation process is defective initial *remedies* can turn out to be lethal instead.

In the beginning of this thesis an instinctive proposition was made – that a poison pill is a low risk, but a high reward defence mechanism against hostile takeovers. Nevertheless, with respect to the conducted research, this proposition has to be, at least to some extent, discarded. In regard to that, two points shall be addressed. Firstly, poison pills may not seem complicated to implement in theory, and their implications and consequences fairly simple to anticipate. However, that is not always the case in practice. There are numerous unknown variables that can either turn out to be favourable or disadvantageous effects of the triggered poison pill. When evaluating different situations in which poison pills can be used, it is worth noting that they almost never come without a price. Even if it reaches its initial and primary goal of averting the takeover attempt, either target company's or existing shareholder's value will be decreased as a result of issued additional shares. Secondly, poison pill can have additional negative impact. Especially problematic situations arise when poison pills are implemented not in the interest of the company as a whole, but rather their own personal interest. In these instances, there is a high probability that implementation of a poison pill would result significant harm to both company and the shareholders. The fact that the poison pills can be adopted without the prior approval on the side of shareholders creates a genuine concern regarding the abuse of defence mechanisms for their own self-preservation.

Second proposition made earlier in this thesis was that the use of a poison pill surpasses *simple* classification as only being a defence method, but also a strategy to gain a leverage and a bargaining power within the takeover process. This proposition can be upheld in its entirety. Not only does poison pill serve as a takeover deterrent, but can also have an auxiliary and sole, distinctive purpose of a bargaining tool in order to increase the shareholder's value, even when shareholders are not necessarily opposed to the takeover but merely want to procure highest possible price for their shares. Adoption of a poison pill provides the target company with a significant amount of leverage, arising from the mere fact that the target company is the one to decide whether it will accept the bidders' offer once the poison pill is implemented. It thus helps the managing board to bargain more effectively, while increasing the target company's power. If the bidder insists in taking over its targeted company, it will only raise its initial offer until the target company accepts it. However, the bargaining power that comes from this type of poison pill implementation does not come without a risk. It is possible that bidder abandon its takeover attempts which will leave the target company in an unenviable position – with no premium offer and decreased market value due to the number of shares issued.

There is a centuries old sentiment that only the dose makes the poison. Although the sentiment was primarily addressed to the alchemy and medicine, the parallels are ever present in all other aspects of human life. It is no different when it comes to defensive measures against hostile takeover. There is a fine line between a perfectly prepared and dosed remedy on one side and irrecoverable poisonous approach on the other. Poison pills can be either and it is in the hands of the management to administer the correct dosage.

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