HOSTILE TAKEOVERS AND DEFENCE STRATEGIES

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I hereby declare that the work submitted is mine and that where I have made use of another's work, I have attributed the source(s) according to the Regulations set in the Student's Handbook.

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Abstract

This dissertation was written as part of the LLM in Transnational and European Commercial Law, Mediation, Arbitration and Energy Law at the International Hellenic University. The aim of this thesis is to present a comprehensive analysis of the phenomenon of hostile takeovers and the basic defense strategies that can be adopted against them.

First a reference has been made to the theoretical background of the scheme of takeovers in general, for the best understanding of the terminology which is various in this field. Then, hostile takeovers are presented and in this stage it was crucial a division among the preliminary takeover steps and the main takeover tactics.

The second part of this thesis is about the defence strategies that can be adopted against hostile takeovers and case law references are used as paradigms. Defence strategies are also divided in proactive and active defence measures. In general, the target of this study is to give prominence to the most famous defence strategies and to point out when these are chosen as a tactic by the acquired company.

Last part of this thesis refers to the European framework for the hostile takeovers which refers to the EU Directive on Takeover Bids: Directive 2004/25/EC and its basic articles. In this part, the thesis focuses on proposals for achieving the initial goal of the Directive, the creation of a unified European system on the field of takeover bids.

Keywords: hostile takeovers, defense strategies, EU Takeover Regulation

Eleftheriadou Ioanna
13/02/2018

Preface

Before you lies the dissertation: “Hostile Takeovers and Defence Strategies”, which constitutes a study of hostile takeovers with references to the US law and a specific analysis of the European framework. Moreover, this dissertation was written to fulfill the graduation requirements of the LLM Program in Transnational and European Commercial Law, Mediation, Arbitration and Energy Law at the International Hellenic University of Thessaloniki. I took the decision to work on this subject after having attended the class of “Mergers and Acquisitions”, taught by Pr. Thomas Papadopoulos, which gave me my motivation to learn more about the M&A field of commercial law.

The subject of this dissertation has the characteristic of having very few bibliographic references, since it concentrates more on the practical side of acquisitions and not so much on theoretical schemes. For that reason, I was focused more on articles, electronic databases and case law which gave me a clear picture of the hostile takeovers and defences against them, in practice.

I would like to thank my thesis supervisor Prof. Thomas Papadopoulos for his constant assistance and his encouragement during my research and writing process. Moreover, I would also like to thank Prof. Dr. em. Athanasios Kaissis for the excellent organization of the program and acknowledge all the members of the academic staff, who supported my post-graduate studies. Finally, I would like to express my deep gratitude to my beloved family and my husband for immensely encouraging and supporting me during my years of study.

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Contents

***ABSTRACT* ....IV**

***PREFACE* ....V**

***INTRODUCTION*...1**

***THEORETICAL ANALYSIS OF A TAKEOVER*...2**

TAKEOVER DEFINITIONS...2

TAKEOVER MOTIVATIONS AND MECHANISMS.. 3

A HOSTILE TAKEOVER 4

***PRELIMINARY TAKEOVER STEPS* 5**

ESTABLISHING A TOEHOLD...5

BIDDING STRATEGIES 6

CASUAL PASS 7

BEAR HUG..7

***MAIN TAKEOVER TACTICS* 8**

TENDER OFFERS 9

PROXY FIGHTS 11

***DEFENCE STRATEGIES*.. …13**

PROACTIVE MEASURES OF A DEFENCE STRATEGY..14

AN EARLY WARNING SYSTEM...15

STAGGERED BOARD..15

POISON PILL..16

GOLDEN PARACHUTE..18

ACTIVE MEASURES OF A DEFENCE STRATEGY..19

GREENMAIL DEFENCE...19

WHITE KNIGHT DEFENCE...21

WHITE SQUIRE DEFENCE..22

PAC- MAN DEFENCE……………………………………………………………………………………………23
CROWN JEWEL DEFENCE…………………………………………………………………………………...24
CAPITAL STRUCTURE CHANGES…………………………………………………………………......25
LITIGATION………………………………………………………………………………………………………..26

THE EUROPEAN FRAMEWORK………………………………………………………………………………27

THE MANDATORY BID RULE………………………………………………………………………………..28
THE BOARD NEUTRALITY OR NON- FRUSTRATION RULE………………………………………29
THE BREAKTHROUGH RULE…………………………………………………………………………......31
THE RECIPROCITY RULE…………………………………………………………………………………….32
PROPOSALS FOR A UNIFIED EUROPEAN SYSTEM………………………………………………….33

CONCLUSION ……………………………………………………………………………………………………35

BIBLIOGRAPHY …………………………………………………………………………………………………37

Introduction

The corporation's legal personhood is a fiction which creates and guarantees many powers and rights for the corporations. Among these powers, corporations have the right to hold, acquire and dispose of stock of other corporations, through a merger or other acquisition device. Moreover, corporations can also be acquired by natural persons and other entities, but the vast majority of corporate takeovers are affected by other corporations. [1] The rationale for corporate takeovers is traditionally couched in terms of maximizing stock- holder wealth and that firms will make acquisitions only if they believe it will enhance stock prices.[2] In addition, it seems that the quickest way for a corporation to increase its size or diversify into unrelated activities is to make major corporate acquisitions and for that reason management boards sometimes pursue takeover and merger activities even if stockholders suffer reduced returns (Reich, 1983).[3]In practice, mergers and acquisitions seem to be the new-age way for a corporation to expand and become transnational. One kind of corporate acquisitions is the takeovers, which can be divided in two categories: *the friendly and the hostile.*

Friendly takeovers are those where the target company is approached by the intending acquirer with a bid and they both discuss and negotiate for the forthcoming acquisition. The target company may agree or not, to sell its stake to the acquirer.[4] Sometimes, when the acquisition is negotiated, the target is willing to be bought and may even have initiated the acquisition by searching itself the buyer.[5] Through a friendly takeover, matters may arise such as which will be the process by which the acquisition will take place, which will be the duties of management and how much is the risk of the competing bidders. [6] Nevertheless, since the terms of the takeovers are all negotiable, those matters can be solved with cooperation among the acquirer and the target corporation.

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[1] Bainbridge M. Stephen, (2009). Mergers and Acquisitions in Corporate Law, 2nd edition, Concept and Insight Series, Foundation Press, p. 337

[2] Firth Michael, (1991), "Corporate Takeovers, Stock holder Returns and Executive Rewards", University of Colorado, USA, Managerial and Decision Economics, Vol. 12, 421-428

[3] Ibid

[4] Knight/Rider Tribune News Service, (2006), "Any idea about hostile takeovers?" *The Economic Times,* section Business and Financial News, http://economictimes.indiatimes.com

[5] See below: White Knight defence strategy

[6] Bainbridge M. Stephen (2009) Mergers and Acquisitions in Corporate Law, 2nd edition, Concept and Insight Series, Foundation Press, p. 337

On the other hand, a 'hostile takeover' is the acquisition of one company, which is called the target company by another one, who is known as the acquirer. The term is also defined as when a company puts a bid on a target firm, which is being opposed by the management of the targeted company which furthermore advises its shareholders not to sell to the acquiring firm (Savela, 1999).[7] Does this phenomenon of hostile takeovers exist or is it just a theoretical structure? In fact, the past 30 to 40 years, in the US and the UK, there has been a growing culture of hostile bids. [8] In this point, a terminology analysis is crucial, since the field of Mergers and Acquisitions is vast and complicated.

THEORITICAL ANALYSIS OF A TAKEOVER

Since many different terms are used in the field of mergers and acquisitions it is advisable to define the framework in which hostile takeovers are integrated. For this scope, the most crucial takeover definitions are above analyzed.

TAKEOVER DEFINITIONS

In general, an *acquisition* is also known as a *takeover* and the meaning of both is the buying of one company (the target) by another company. As already mentioned an *acquisition* may have a friendly and negotiated character or may be hostile and based on a strategic plan in order to be accomplished. The most usual meaning of an acquisition is the purchase of a smaller company by a larger and more dynamic one.

In a few lines, a *takeover* may be defined as a transaction or series of transactions whereby a natural or legal person or group of persons acquires control over the assets of a company, either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company.[9] There is also the phenomenon, where the smaller company acquires management control of a big one and the

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[7] Investopedia,(2018), https://www.investopedia.com/

[8] Bell Emily, (1999), Business focus: The Mannesmann Battle: Vulture versus old culture; Emily Bell asks if Germany is out of step on hostile takeovers. *The Observer Business,* pg. 4

[9] Papadopoulos, Thomas, (2008) The European Union Directive on Takeover Bids: Directive 2004/25/EC (2008). International and Comparative Corporate Law Journal, Vol. 6, No. 3, pp. 13-103

combined entity retains the name of the initial small company. This kind of acquisition is known as a *reverse takeover*.[10]

Furthermore, a *merger* is an amalgamation between companies of similar size in which either the members of the merging companies exchange their shares for other shares in a new company or the members of some of the merging companies exchange their shares for shares in another merging company. The basic distinction between a takeover and a merger is that in a takeover the control of the assets of the acquired company passes to the acquirer while in a merger, the shareholding in the merged company is spread among the shareholders of the two initial companies. [11]

Also known type of acquisition is the *reverse merger,* through which a private company buys a publicly listed shell company and this is a way of going public without the expenses and time required by an IPO (initial public offering). [12] In a few words, an initial public offering is the first time that the stock of a private company is offered to the public and as a process with many stages, demands also many costs. [13]

TAKEOVER MOTIVATIONS AND MECHANICS

Motivations for a corporation to take over another corporation might be to expand product breadth, a geographic scope or a customer base. Moreover, maybe the corporation tends to expand horizontally or vertically[14], diversify into different product markets, pursue unvalued resources or manipulate financial indicators such as risk profiles. More or less, a hostile takeover represents a battle for corporate control and most commonly it evolves an outside entity, usually a corporation, which attempts to approach the shareholders of the target firm, through different mechanisms. [15]

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[10] Papadopoulos, Thomas, (2008) The European Union Directive on Takeover Bids: Directive 2004/25/EC (2008). International and Comparative Corporate Law Journal, Vol. 6, No. 3, pp. 13-103

[11] Ibid

[12] Giddy Ian, (2009), ‘Mergers & Acquisitions: Definitions and Motivations’, NYU *STERN* <http://pages.stern.nyu.edu/~igiddy/articles/mergers_and_acquisitions.html> accessed 7 December 2017.

[13] Investopedia, (2018), https://www.investopedia.com/

[14] “Horizontal integration is the act of integrating other infrastructures, assets and companies of the same industry or in the same level o production. Vertical integration is the act of expanding into new operations for the purpose of decreasing a firm’s reliability on other firms in the process of production and distribution.” Analysis by Kimmons Ronald, (2018),“What Are the Differences Between Vertical & Horizontal in Strategic Management?”in http://smallbusiness.chron.com/differences-between-vertical-horizontal-strategic-management-24460.html

[15] Pearce John A. and Robinson Richard B.,2004, Article in “Hostile takeover defences that maximize shareholder wealth”, *Business Horizons 47/5*

A HOSTILE TAKEOVER

For the scope of this part of the thesis, a comparison among hostile takeovers and friendly takeovers is crucial. First, a friendly takeover has the advantages of being a less costly process and also minimizes the loss of key persons, customers and suppliers which may arise during the hostile takeover and the fight for the control of the target.[16] If the raider chooses a friendly takeover attempt, he makes a "take it or leave it" offer for the whole company and in this case, if the board agrees to the proposed merger, the shareholders vote on whether or not to accept the offer. [17]

In the hostile takeovers, where the target doesn't accept the friendly approach of the bidder, the acquirer has to either abandon its effort or resort to more aggressive tactics. These tactics, at a glance, seem to be less effective, due to extra time and money which is wasted, since the target company activates defense strategies in order to avoid the hostile acquisition.[18]

In general, in a *hostile takeover*, the management of the target company does not agree with the acquisition of the company and objects to it. The acquiring company fulfills a strategic plan in order to achieve the acquisition. In practice, a hostile takeover can be accomplished through two main tactics: a tender offer and a proxy fight. Each tactic has its pros and cons, which are going to be analyzed.

The first tactic, a tender offer, is a resort for the acquiring company when the friendly negotiation does not appear to be effective. Through a tender offer, the bidder may have the opportunity to circumvent the target's management board and obtain the control. The second tactic, a proxy fight, is an attempt by the shareholders to take the control of the company through the use of the proxy mechanism of corporate voting[19]

Before those main tactics, the part of preparation of a hostile takeover consists of preliminary steps, which most of the times end up to a main tactic.

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[16] DePamphilis M. Donald, (2009), The Corporate Takeover Market in Mergers, Acquisitions and Other Restructuring Activities, An integrated Approach to Process, Tools, Cases and Solutions, fifth Edition, pg 102

[17] Schnitzer Monika,(Feb 1996), Hostile versus Friendly Takeovers, Economica, New Series, Wiley on behalf of The London School of Economics and Political Science and The Suntory and Toyota International Centres of Economics and Related Disciplines, Vol. 63, No 249 ,pp. 37-55

[18] DePamphilis M. Donald, (2009), The Corporate Takeover Market in Mergers, Acquisitions and Other Restructuring Activities, An integrated Approach to Process, Tools, Cases and Solutions, fifth Edition, pg 102

[19] Gaughan A. Patrick, (2011), Takeover Tactics in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, p.p. 243-271

PRELIMINARY TAKEOVERS STEPS

Preliminary takeover steps are the first part of a hostile strategy and their role in the takeover is that they create the right conditions for a successful acquisition of the target. An analysis of the main preliminary steps is crucial in this stage, since those constitute the preparation for a successful takeover.

ESTABLISHING A TOEHOLD

Establishing a toehold is one famous preliminary takeover step according to which a hostile bidder begins an accumulation of the target's company shares. In this way, the bidder seeks to establish a toehold from which to launch its hostile bid. A serious advantage of establishing a toehold is that the bidder may be able to avoid the payment of a premium, if the market is unaware of its actions. In addition, the bidder may gain some of the same rights that other shareholders of the target company have. [20]It is surprising that, despite their theoretical benefits, toehold strategies are not really common and as B. Espen Eckbo, a senior business professor at Dartmouth, pointed out: "not only the toehold play is less frequently executed, but in recent years they have rarely proven successful." [21]

This accumulation might be spotted through an early warning system, which is a defense measure that controls the mobility of the target's shares, for the scope of being aware that a bidder is preparing for a hostile takeover. It seems that establishing a toehold is difficult to be successful, since nowadays most of the corporations have adopted such defence measures.

[20] Gaughan A. Patrick, (2011), Preliminary Takeover Steps, Establishing a Toehold in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 245

[21] Marino Jonathan, (2009), Wither the Toehold; even with share prices down, few buyers look to accumulate a stake ahead of a deal. Mergers & Acquisitions, *The Dealmaker's Journal* , pg. 14

BIDDING STRATEGIES

Planning bidding strategies is also a crucial preliminary takeover step. In general, a takeover bid is a type of corporate action through which an acquiring company makes an offer to the target company's shareholders to buy the target's company shares and gain the control of the business. Some kinds of takeovers bids are:

1) Two-Tier Bids: The acquiring company offers to pay a premium which exceeds the share's price in order to convince shareholders to accept the bid.

2) Any-and-All Bid: The acquiring company offers to buy outstanding shares of the company, means shares which refer to the company' s stock currently held by all its shareholders, at a specific price.[22]

When creating a bidding strategy, the bidder has to consider the responses of not just the target company but also the other bidders. A key for the initial bidder is to prepare and structure is initial bid in this way, so that it will preempt the other bidders and avoid overpaying. This can be defined as the optimal bid.[23]

As the evidence shows, the target company may force the bidder to raise the offer price, reject all offers by the initial bidder in favor of a rival end even reject all bidders. In sum, initiating a bidding strategy is a risk that the acquiring company takes.[24] In this stage, I believe it is crucial for the bidder to evaluate the financial data and weigh the situation. If the offer price is extremely raised and the result of the takeover won't be the desirable for the bidder, then the whole acquisition won't be advantageous and the right move should be to withdraw the offer. A well established bidding strategy should present from the start, the point in which the best for the bidder is to totally recede from the takeover.

In a few lines, pre bid planning should involve a review on the target's defences, an assessment of these defenses that may be activated after the bid is made and the size of the float associated with the target's stock. Poor planning may results to a poor and unsuccessful bidding strategy. [25]

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[22] Investopedia,(2018), https://www.investopedia.com/

[23] Gaughan A. Patrick, (2011), Preliminary Takeover Steps, Establishing a Toehold in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 246

[24] Eckbo B. Espen, (2008), Bidding strategies and takeover premiums: A Review, Tuck School of Business at Dartmouth, Working Paper No. 2008-48, forthcoming Journal of Corporate Finance

[25] DePamphilis M. Donald, (2009), The Corporate Takeover Market in Mergers, Acquisitions and Other Restructuring Activities, An integrated Approach to Process, Tools, Cases and Solutions, fifth Edition, pg 102

CASUAL PASS

As a preliminary takeover tactic, a casual pass, is an informal attempt to approach the management of the target, before initiating the takeover process. It may start from the bidder's management or from its representatives. A casual pass may be used if the bidder feels unsure of the targets' response but it may also act against the bidder since it provides the target of information and notifies for the bidder's interest. The bidder usually initiates contact casually through an intermediary, such as its investment banker. [26]

Through this tactic, the bidder has the opportunity to elicit clues from the target's management and be prepared for the outcome of the acquisition. As mentioned, there is always the risk that the target will be prepared for the takeover and may even activate its defences, before the initiation of the takeover. In any case, the right move for the bidder should be to approach the management, without revealing all its hostile weapons.

BEAR HUG

A bear hug is a preliminary takeover step according to which the acquirer corporation makes a very generous offer to buy the target's shares for a much higher per- share price that what the target is worth. The name of this tactic reveals the persuasiveness of the offer.[27]

Bear-hugs are driven by the bidder's desire for the target co- operation, particularly those bidders most of the times wish to use a scheme of arrangement or need to gain access to due diligence before committing to a deal. Moreover, the tactic is used when the bidder suspects that its offer won't be welcomed with open arms by the target and uses the bear hug for the scope of bringing the proposal to the attention of target shareholders, in the hope that the shareholders will pressure the board to negotiate with the bidder. [28]

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[26] Gaughan A. Patrick, (2011), Preliminary Takeover Steps, Establishing a Toehold in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 246

[27] Investopedia, (2018), https://www.investopedia.com/

[28] Karen Evans- Kullen, (2012), "Will the bear hug replace the hostile takeover?", https://www.claytonutz.com/knowledge/2012/march/will-the-bear-hug-replace-the-hostile-takeover

Since, the target's company management is legally obligated to support its shareholders interests; this extra generous offer forces the management to accept of being acquired. In case of refusing the offer, the shareholders of the company may file a lawsuit if this refusal is not well stated and justified. [29]

Due to the very generous character of the "bear hug" as a tactic, we could say that a bear hug is a kind of a friendly approach of a takeover and not a preliminary step for a hostile one, since the bidder scopes to negotiate with the target and through its offer the target will earn serious profit.

Microsoft's Bear Hug Bid for Yahoo

A very famous bear hug case was the Microsoft's bear hug bid for Yahoo. In 2009, Microsoft announced its interest to acquire Yahoo through a bear hug and offered $44.6 billion for the takeover. Microsoft tried to level up the pressure by stating that if its offer wouldn't be accepted, they would try to use a proxy fight.[30] Microsoft hoped that the bear hug would puss institutional investors to press the board for accepting the attractive offer. Due to that pressure, Yahoo's chief executive officer (CEO) had to step aside and the companies entered into an agreement. Microsoft didn't manage to takeover Yahoo but achieved to create an Internet search partnership with Yahoo's search engine and the deal also brought advertising revenue to Yahoo.[31]

MAIN TAKEOVER TACTICS

If the takeover of the target wasn't successful, after the preliminary takeover steps, the bidder proceeds to the next step and implements a hostile strategy for pursuing the acquisition. As above analyzed, the main tactics for a hostile takeover are the tender offers and the proxy fights.

[29] Investopedia, (2018), https://www.investopedia.com/
[30] See below: Main takeover tactics
[31] Gaughan A. Patrick, (2011), Preliminary Takeover Steps, Bear Hugs in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 249

TENDER OFFERS

A tender offer is the technique of acquiring control of a corporation by making a public offer to purchase a part of the corporations' stock at a fixed price. Tender offers had been widely used in the United States in recent years and are regulated by the Williams Act (USA) which refers to 1968 amendments to the Securities Exchange Act of 1934.[32] In fact, in 1965 there were twenty-nine cash tender offers to acquire control involving companies listed on the New York Stock Exchange and fifteen involving companies listed on the American Stock Exchange.[33]

Moreover, the Williams Act was passed to protect shareholders in the course of takeovers and tender offers, through granting the U.S. Securities and Exchange Commission (SEC) and the courts the power to manage problems that may arise. Despite its scope, the Act did not define what constitutes a "tender offer" and it has, been left to the courts to formulate an exact definition.[34] Therefore, in a famous case, *Wellman v. Dickinson*[35], the court set forth the *Eight Factor Test*, regarding the definition of a tender offer. The eight factors were suggested by the SEC to determine in which cases a purchase constitutes a tender offer· the so- called *"Wellman test"*. These factors are the following and not all need to be present in each transaction:

1) Active and widespread solicitation of public shareholders;

2) Solicitation made for a substantial percentage of the target's stock;

3) Offer is at a premium to the prevailing market price;

4) Terms are fixed rather than negotiable;

5) Offer contingent on the tender of a fixed minimum number of shares to be purchased;

6) Offer is only open for a limited period of time;

7) Offerees are subjected to pressure to sell their stock; and

[32] According to Wikipedia, The Williams Act amended the Securities and Exchange Act of 1934 for the scope of requiring mandatory disclosure of information regarding cash tender offers.

[33] Fleiscer Arthur, Jr. And Mundheim Robert H., (1967), "Corporate Acquisition by Tender Offer", University of Pensylvania Law Review, Vol 115, pp. 317-370

[34] Gaughan A. Patrick, (2011), Preliminary Takeover Steps, Tender Offers in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 250

[35] See Wellman v. Dickinson, 475 F. Supp. (SD NY 1979), aff'd632 F.2d 355 (CA2 1982), cert. denied, 460 U.S. 1069 (1983)

8) Public announcements of a purchase program for the target's securities precede or accompany rapid accumulation of large amounts of the target's securities.[36]

The *"Totality of the Circumstances Test"*

Moreover, except for the tender offer rules, other courts for defining a transaction as a tender offer, focus also on whether there is a likelihood that there will be a substantial risk that persons solicited will lack the needed information in order to make a careful valuation of the bidder's proposal. [37]

In practice, a tender offer as a hostile strategy has its pros and cons. For start, as a technique is simple in its business and legal mechanics. Moreover, it is a cheap tactic since the major expense is the price of the shares bought and this purchase price is a reasonable investment, in the framework of a takeover. Even if the bid fails, the acquirer may be able to sale any shares acquired in the open market and gain a profit.[38]

Instead, the use of a tender offer has its costs also. For instance, the company making the offer doesn't have the opportunity to make a detailed investigation related to this specific transaction. Moreover, the offeror doesn't have the protection of the representations and warranties which are made through the agreement of a merger or for sale of assets. Also, the acquiring company frequently pays more for each share of stock in the block it acquires than it would pay for each share, if it would acquire all the shares of the target.[39]

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[36] Bowerman Freed Amy and Johnson Alexander B., (2007), Tender Offers, Securities Law for Non-Securities Lawyers
http://files.alicle.org/thumbs/datastorage/skoobesruoc/pdf/30FreedTenderOffersCH001_thumb.pdf

[37] See Rand v. Anaconda-Ericsson, Inc., 794 F.2d 843, 848-49 (2d Cir. 1986), cert. denied, 479 U.S. 987 (1986) (citing Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985)).

[38] Fleiscer Arthur, Jr. And Mundheim Robert H., (1967), "Corporate Acquisition by Tender Offer", University of Pensylvania Law Review, Vol 115, pp. 317-370

[39] Ibid

PROXY FIGHTS

A proxy fight as a main takeover strategy is an attempt by a single shareholder or a group of them to take control of a target company or bring changes, through the use of the proxy mechanism of corporate voting.[40] Proxy fights were fashionable in USA for takeovers in the 1990's and the main reason for this is that tough state anti-takeover laws lead to a proxy strategy. Pennsylvania, for instance, was close to pass legislation that would make hostile takeovers almost impossible to achieve.[41]

Since a proxy fight is a very complicated process, it is easier to be understood if it is broken down into discrete steps:

1) Starting the Proxy Fight: A bidder, who is also a stockholder, attempts to change control of the target company, at the shareholder's annual meeting.

2) The Solicitation Process: Before the stockholder's meeting, the insurgent group of stockholders contacts with other stockholders of the company and tries to convince them to vote against management's candidates for the board of directors or to vote for an acquisition or against certain antitakeover amendments. This contact is usually handled by a proxy solicitor who represents the insurgent group of stockholders. On the other hand, the management board may hire a proxy firm as a representative and a proxy contest begins, during which the stockholders are repeatedly called to be convinced, by the proxies, to stand with their client's position.[42]

3) The corporate voting process: After receiving the proxies' pressure, stockholders may then forward their votes to a designated collector and the votes are sent to the proxy clerks at the brokerage firms, to tabulate them The brokerage firm, submits the vote results before the company's meeting and during the tabulation process, voting inspectors and proxy solicitors supervise end ensure their clients' interests.[43]

[40] Shea Edward, (New York:1999), The McGraw- Hill Guide to Acquiring and Divesting Businesses, pgs 335-336
[41] Regurly Eric, (April 3, 1990), "Proxy fight fashionable for takeovers", The Financial Post (Toronto, Canada), Daily Edition, section 1, News, pg 3, Inside New York
[42] Shea Edward, (New York:1999), The McGraw- Hill Guide to Acquiring and Divesting Businesses, pgs 335-336
[43] Gaughan A. Patrick,(2011), Preliminary Takeover Steps, PROXY FIGHTS in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pgs 271-281

Microsoft and Yahoo proxy battle

A very well-known proxy battle was held among *Microsoft and Yahoo*, since Microsoft threatened to launch a hostile bid for Yahoo if the board didn't reconsider the software giant's Jan. 31 offer of $44.6 billion in cash and stock. This proxy battle was similar to one that Carl Icahn dropped against Motorola Inc. in exchange for the company' s support of two of his nominees for the board of directors.[44]

HP and Compaq proxy battle

"The most famous case of proxy fight was Hewlett-Packard's takeover of Compaq. The deal was valued at 25$ billion. But Hewlett- Packard reportedly spent huge sums on advertising to sway shareholders. HP wasn't fighting Compaq- they were fighting a group of investors that included founding members of the company who oppose the merge. About 51 percent of shareholders voted in favor of the merger. Despite attempts to halt the deal on legal grounds, it went as planned." [45] Through case law we can understand in a better way what a hostile takeover is and how a defensive method works. In this specific case, HP wanted to achieve the takeover and used as a weapon the advertising, in order to make the shareholders more vulnerable, to accept the merger.

Despite the fact that proxy fights have their sponsors which believe that the main advantages to a proxy fight are speed and low overall cost, other find problems in this process such as:

1) Many companies have already set up defenses against proxy-fight takeovers. The most popular defense is to give directors staggered terms[46] and if only a minority of directors come up for re-election each year, it could take years to oust the entire board.

2) Proxy fights require risking and substantial out-of-pocket costs and

[44] Joseph Alex, (April 9, 2008) "What's a "Proxy Battle?, Just what was Microsoft threatening to do to Yahoo?",http://www.slate.com/articles/news_and_politics/explainer/2008/04/whats_a_proxy_battle.html, http://www.slate.com/

[45] Yadav Ayush, (2011), "Hostile Takeovers and its Defense Tactics", Institute of Law, Nirma University, Ahmedabad, India

[46] See bellow: Defense Strategy of a staggered board

3) *Even investors who dislike management might not go along with a proxy fight and unless there is a large group of disappointed investors holding a stock, many won't follow the bidder and that can make a proxy fight drag on for a long time,* as said Edward Moore of arbitrage firm Moore Grossman & de Rose.[47]

When a hostile takeover takes place, leads to a disagreement between the shareholders of the target company and its board of directors, who have a negative position for this specific bid. When a target faces this situation, the directors are obliged to create a defense strategy, in order to protect their position or to ensure that the terms of the bid are going to be improved. There are many defense strategies and sometimes a combination of more of them becomes a useful tool, for reacting to a hostile takeover. Scope of this paper is to examine the most popular of them and emphasize on their crucial elements.

DEFENCE STRATEGIES

During the 1980's, corporate takeovers reached new levels of hostility and by the end of the same period, the defensive strategies became very complex and sophisticated. Investment banks in cooperation with managements of large corporations, started to organize and adopt defence measures for facing the aggressive raiders of the fourth merger wave.[48]

Due to the fact that takeover bids most of the times offer stockholders a premium for their shares, defense strategies are sometimes viewed as barriers to increased shareholders wealth. Despite that, among the most common rationales to defend against a hostile takeover are: the desire to retain autonomy or management control, the preference for a different partner, the belief in a tradition mission that would be compromised by new management and last the desire to negotiate a more favorable and prosperous takeover. The other perspective argues that executives of target firms adopt defensive measures in order to maintain their power positions

[47] McComick Jay,(November 7, 1989), "Proxy fights still attract scepticism", USA TODAY, Final Edition, Section: Money; Pg. 1B

[48] Gaughan A. Patrick, (2011), Preliminary Takeover Steps, Proxy Fights in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 183

and compensation levels, while fearing the change of the controlling interests. Due to this executive motivation, the management's actions do not necessarily reflect the best interests of stockholders.[49]

Furthermore, the first and more crucial steps for creating a defense strategy are: being aware of the threat and take prevention measures. Preventative measures seem to be an exercise in a wall building. Higher and more resistant walls need to be continually designed and installed for the target company in order to face the raiders with their investment and legal advisors, who create the hostile strategies.[50]The target companies must count on the risk exists and their management board should be informed for all the defensive measures and techniques, in order to avoid losing the company's control and consequently their jobs.

Moreover, a defence strategy is a combination of different measures, which can be divided into *proactive or preventive* and *reactive or active measures*. Particularly, proactive or preventive measures are used for making companies less attractive before the hostile takeover and reactive or active measures are employed after a hostile bid has been attempted.[51]

PROACTIVE MEASURES OF A DEFENCE STRATEGY

Famous proactive measures of a defence strategy are the following:

- An Early Warning System
- Staggered Board
- Poison Pill
- Golden Parachute

[49] Pearce John A. And Robinson Richard B.,(2004), Article in "Hostile takeover defences that maximize shareholder wealth", *Business Horizons 47/5*

[50] Gaughan A. Patrick, (2011), Antitakeover Measures in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 185

[51] Goutham G. Shetty, (2018) "Hostile takeover Defenses-I",https://www.slideshare.net/mahtuoggs/hostile-takeover-defenses

AN EARLY WARNING SYSTEM

In the first proactive measure of a defence strategy of having an *Early Warning System*, the target company adopts a system of monitoring the trading of its shares (trading patterns), in order to check the distribution of share ownership and movements of the shareholders. This is a way for the board to estimate the dangerous takeover and take prevention measures afterwards. A sudden and unexpected increase in trading level may signal the presence of a hostile bidder to accumulate shares before the announcement of its takeover intentions.[52]

Through this early warning system, the target has to ability to locate hostile moves such as "establishing a toehold" and prepare for the oncoming attack. This system should be observed by specialists who have the ability to distinguish the suspicious shares mobility and refer to the board, for the scope of adopting a defense strategy.

STAGGERED BOARD

In the second defence proactive measure[53], the corporation has a staggered board for which the company's shareholders have to give their approval.[54] If they do, the board members won't be elected annually; instead only a group of members will be submitted for reelection ever year. Consequently, if the acquiring company aims to replace the entire board, by buying shares, in order to gain the control of the company, it will need more time and money.[55]

In practice, a staggered board makes it very difficult for a hostile bidder to gain control over the incumbent's objections, since it causes serious delay to the whole process and even a year in the dynamic corporate world has its meaning. Moreover, the costs from this delay are extremely high and managers are provided with

[52] Gaughan A. Patrick, (2011), Preventative Antitakeover Measures in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 185

[53] Also known as the classified board defense

[54] Goutham G Shetty, (2018)"Hostile takeover Defenses-I",https://www.slideshare.net/mahtuoggs/hostile-takeover-
defenses,

[55] Yang Erik and Zarin Samim, (Spring 2011), Bachelor thesis in "Mergers & Acquisitions: Hostile takeovers and defense strategies against them", Department of Business & Administration, International Business, School of Business, Economics and Law, University of Gothenburg

stronger protection from a hostile takeover[56], since its positions in the company are much more stable.

As mentioned above, having a *staggered board* is the best defence for the hostile tactic of *a proxy fight*, since if only a minority of directors come up for re-election each year it could take years for the bidder to change the entire board.[57] This delay is often associated with extra expenses which can make it more difficult getting finance for the acquiring company and due to this the target company becomes less attractive. This tactic acts more or less as a threatening or delaying measure since in every case the bidder cannot be stopped from acquiring a big block of shares and eventually gaining the control of the company. To sum up, the staggered board strategy is moderately effective on its own[58] and has only a proactive defensive character.

POISON PILL

A "*Poison pill*" is a generic term that refers to protection against an unsolicited tender offer and as a proactive defensive measure belongs to the contractual mechanisms that strengthen a target company.[59] In general, the 'poison pill' is a tactic used by a company that fears an unwanted takeover, through which the target ensures that a successful takeover bid will trigger some event that substantially reduces the value of the company. Moreover, a poison pill is a rights plan that gives the power to existing shareholders to control securities or cash in the case of a

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[56] Lucian Arye Bebchuk, John C. Coates IV and Guhan Subramanian , (May, 2002) "The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy" Stanford Law Review, Vol. 54, No. 5, pp. 887-951

[57] McComick Jay, (November 7, 1989), "Proxy fights still attract scepticism", USA TODAY, Final Edition, Section: Money; Pg. 1B

[58] Yang Erik and Zarin Samim , (Spring 2011), Bachelor thesis in "Mergers & Acquisitions: Hostile takeovers and defence strategies against them", Department of Business & Administration, International Business, School of Business, Economics and Law, University of Gothenburg

[59] Tiwari Rahul, (2008), Working paper on "Merger and Acquisition, Defence Strategies Adopted by Companies ", //www.slideshare.net/Rahulmbaguy/defenses-against-hostile-takeovers, submitted to prof. Ramakrishnan

hostile takeover. In the opposite case, of a friendly bidder who takes control of the company, these rights are redeemable at the option of the board.[60]

Specifically, poison pills are inactive rights until they are triggered and after their implementation they can only be redeemed by the board of directors. These rights are triggered when an unwanted shareholder acquires a pre-specified amount of stock, which has been agreed by the board of directors[61]. With a poison pill, the target company tries to make its stock less attractive to the acquirer.[62]

There are different types of poison pills: the *'flip-over'* pills and the *'flip-in'* pills. In a *flip-over* pill plan, the rights become part of the company's common stock and cannot be traded separately. These rights can be separated from the common stock and become exercisable only when a prospective acquirer shows up who announces or intends to acquire some specified percentage of the issuer's stock, most of the times the twenty percent (trigger level). This is commonly called as the distribution event and after this, the issued rights become active and exercisable. The pill's flip-over feature is that it is triggered after the acquisition, when the target is merged into the acquirer and the holder of each right becomes entitled to purchase common stock of the acquiring company, in half price.[63]

One serious drawback of this 'flip-over pill' is that it is triggered after the acquirer has obtained the full ownership of the company. Due to this serious drawback, transaction planners developed the other form of poison pills, the *flip-in* pill. The flip-in pill is triggered by the actual acquisition of some specified percentage of the issuer's common stock. The key feature is that, when triggered, the flip-in pill entitles the holder of the right, *except for the acquirer and its affiliates or associates,* to buy shares of the target's common stock at half price. The value of the common stock

[60] Papadopoulos, Thomas, The European Union Directive on Takeover Bids: Directive 2004/25/EC (2008). International and Comparative Corporate Law Journal, Vol. 6, No. 3, pp. 13-103, 2008.

[61] Yang Erik and Zarin Samim , (Spring 2011), Bachelor thesis in "Mergers & Acquisitions: Hostile takeovers and defence strategies against them", Department of Business & Administration, International Business, School of Business, Economics and Law, University of Gothenburg

[62] Papadopoulos, Thomas, The European Union Directive on Takeover Bids: Directive 2004/25/EC (2008). International and Comparative Corporate Law Journal, Vol. 6, No. 3, pp. 13-103, 2008.

[63] Bainbridge M. Stephen, (2009) Mergers and Acquisitions in Corporate Law, 2nd edition, Concept and Insight Series, Foundation Press, pg 379

received when the right is exercised equals to two times the exercise price of the right and this dilution is the flip-in pill's deterrent effect.[64]
In general, poison pills can also keep the good investors away and this is a serious problem. [65] In my scope this is the negative side of this defense tactic, since poison pills may be inactive but even a friendly bidder might choose not to bid for the company, if there is the chance that the board decides to activate them.

GOLDEN PARACHUTE

Golden Parachutes for top executives were created with very specific goals: to ensure that shareholders wouldn't lose out on beneficial M&A deals and to protect executives from the fear of being fired, during the corporate takeover way of the 1980s. By the 1986 about a third of the largest 250 U.S. corporations had adopted a Golden Parachute clause, which became an insurance policy for the executives and in the same time the executives' incentives were aligned with the investors' interests. The whole idea was that a good exit package would prevent the executives to decline deals that might be prosperous for the company's shareholders. [66]
Soon, shareholders and investors began to doubt for these benefits and started to raise questions as to whether such packages were truly in the interest of the firm. Eventually, by the late 1980's, there were numerous lawsuits against a variety of firms over their parachute agreements. Investors and the public still tend to doubt for the Golden Parachutes' defense character and see them as unwarranted and disproportionate payoffs to executives who abandon their firms fragmented. Nowadays, the business world is left to show if the Golden Parachutes will survive, or not. [67]

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[64] Bainbridge M. Stephen, (2009) Mergers and Acquisitions in Corporate Law, 2nd edition, Concept and Insight Series, Foundation Press, pg 382
[65] Tiwari Rahul, (2008), Working paper on "Merger and Acquisition, Defence Strategies Adopted by Companies ", //www.slideshare.net/Rahulmbaguy/defenses-against-hostile-takeovers, submitted to prof. Ramakrishnan

[66] Peer Fiss, (2016), "A Short History of Golden Parachutes", Executive Compensation, Harvard Business Review, https://hbr.org/
[67] Ibid

In its simple form, a Golden Parachute is a provision in a CEO's contract which states that he or she will get a large bonus if the company is acquired. If this acquirement is fulfilled, the managers will be less inclined to block any takeover attempts.[68] Except for this "bare bones" form of a large bonus, the most elaborate "gold plated" parachutes might also include stock grants and options, health insurance, tax indemnification and other benefits.[69]

ACTIVE MEASURES OF A DEFENCE STRATEGY

Proceeding to the active measures of a defence strategy, some of the most important are the following:

- Greenmail Defence
- White Knight Defence
- White Squire Defence
- Pac-man Defence
- Crown Jewel Defence
- Capital Structure Changes
- Litigation

GREENMAIL DEFENCE

Greenmail is the defence method which as a transaction is one of the most controversial control related phenomenon in corporate finance (Bhagat and Jefferis, 1992,). Greenmail refers to the tactic through which the target corporation repurchases a block of its shares from persons declaring themselves as bidders who came to take over the target. Specifically, the incumbent directors authorize payment out of corporate funds for the scope of repurchasing the shares which are already held by the bidder, ending in this way the takeover attempt. A key term of this repurchase agreement is payment of a substantial premium for the bidder's

[68] Grabianowski Ed, (2018) "How hostile takeovers work", https://money.howstuffworks.com/hostile-takeover1.htm, https://www.howstuffworks.com/,

[69] Peer Fiss, (2016), "A Short History of Golden Parachutes", Executive Compensation, Harvard Business Review, https://hbr.org/

share, in exchange for the bidder's agreement not to acquire the firm's shares again or otherwise to seek control of the firm.[70]

Financial economists have advanced three views on greenmail based on prevailing theories about managers and markets. The first, "management entrenchment view", sees greenmail payments as means by which directors strive to retain control of their corporations and at the same time reduce the value of their firms. The second view, "shareholder welfare", argues that even if markets efficiently assimilate public information, directors may have nonpublic information according to which, paying greenmail is the right move for protecting the shareholders of the target company. [71] Last, some economists have supported that, even greenmail harms the remaining shareholders; the payments may be justified as a method of spreading the costs of "policing"[72] managers in order to minimize agency costs. Specifically, when the "policing" managers identify successfully undervalued companies, they bare all the costs for their search but reap only part of the benefit. On the other side, if investors mistakenly spot a company undervalued and invest, they bear full the costs of their mistake and they cannot spread the loss among the other shareholders. This asymmetry makes the process of searching expensive and therefore minimizes the policing activity. Seen in this aspect, greenmail payments might be regarded as a method for spreading the costs of unsuccessful searches, thereby offsetting the benefits enjoyed by free-riders when these searches are successful.[73]

In my aspect, the first hypothesis and aspect of Greenmail seems the most logical and there should be a legally framework which would protect shareholders, since greenmail payments affect their position. Nevertheless, director's decisions are protected by the business judgment rule[74], despite the historic purpose of the rule to benefit shareholders.[75]

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[70] McChesney Fred S., (Mar. - Apr., 1993), Transaction Costs and Corporate Greenmail: Theory, Empirics and a Mickey Mouse Case Study, Wiley, Managerial and Decision Economics, Vol. 14, No. 2, Special Issue: Transactions Costs Economics pp. 131-150

[71] The Harvard Law Review Association, (Mar., 1985), Targeted Stock Repurchases and the Management-Entrenchment Hypothesis Source: Harvard Law Review, Vol. 98, No. 5 pp. 1045-1065

[72] The term "policing" refers to the practice of investors who seek to identify and invest in companies with high agency costs and assets that could be more valuable if managed differently.

[73] The Harvard Law Review Association, (Mar., 1985), Targeted Stock Repurchases and the Management-Entrenchment Hypothesis Source: Harvard Law Review, Vol. 98, No. 5 pp. 1045-1065

[74] The business judgment rule is a case law-derived doctrine in corporations law that courts defer to the business judgment of corporate executives. It is rooted in the principle that the "directors of a corporation... are clothed with

Goodyear Company and Sir James Goldsmith case

One famous case of greenmail involved Goodyear Company and Sir James Goldsmith. Sir James Goldsmith, in 1986, held an 11.5 % stake in Goodyear Company and threatened to take over the company. Goodyear accepted to repurchase from Sir James his shares with the restriction that Sir James wouldn't have the right to purchase any stock from the company, for five years. After the transaction, Sir James gained about $93 million profit, from the premium that Goodyear paid as a defense in his willing to take over the company.[76]

WHITE KNIGHT DEFENCE

About the second method, *White Knight*, it has taken its name from the company which is more favorable for the targeted company, in comparison with the hostile and acquiring one. The term "white knight" typical refers to a potential acquirer invited by the target management to top an initial offer which is opposed by the management.[77] This friendly company takes part as a third party and the management of the targeted company peaks this third party in order to protect its interests.[78] For this scope of protecting its interests, the target management cooperates with the white knight and provides him private information about the source of gains from the potential takeover.[79]

In practice, after the announcement of the initial hostile bid, other raiders also enter the battle and they often offer higher bids than the initial. Among those bidders there are acquirers that are preferable for the target or even been approached in the

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[the] presumption, which the law accords to them, of being [motivated] in their conduct by a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge" Wikipedia https://en.wikipedia.org/wiki/Business_judgment_rule, (2018)

[75] Ibid

[76] https://corporatefinanceinstitute.com/, (2018)

[77] Shleifer Andrei and Vishny Robert W., (1986)," White Knights, and Shareholder's Interest", The Rand Journal of Economics, Vol. 17, No 3. Pp. 293-309

[78] Yang Erik and Zarin Samim, (Spring 2011), Bachelor thesis in "Mergers & Acquisitions: Hostile takeovers and defense strategies against them", Department of Business & Administration, International Business, School of Business, Economics and Law, University of Gothenburg

[79] Shleifer Andrei and Vishny Robert W., (1986)," White Knights, and Shareholder's Interest", The Rand Journal of Economics, Vol. 17, No 3. Pp. 293-309

first place by him, in order to be saved from the initial hostile bidder. These are the "white knights" which are coming as savors of the target company. [80]

A white knight may successfully defend the company but the realistic scope is that the target is obliged to choose either to be taken by the hostile bidder or to negotiate the acquisition with the white knight, but still be taken. That's the default of this defense strategy but the serious advantage is that through the competition, the terms of the bid may be changed and improved. [81]

Nevertheless, the white knight defence tactic has the risk of delivering the control of the company to a "savor" and the next move by the white knight cannot be predicted from the target company. If the white knight changes its motives and plans in the meantime, the savor might even turn to be a "black knight". Another scenario is that there is a chance behind the white knight to be hidden a hostile bidder, who uses the white knight as a proxy with the scope of taking the company in its hands. It seems that this strategy may even act as a boomerang for the target company.

WHITE SQUIRE DEFENCE

A *White Squire* is the term for a firm that aims to purchase a large block of the target company's block but has no interest in acquiring management control. This third friendly party's willingness focuses only on investing or representation in board of the target company. This strategy functions as an obstacle for the hostile company, which loses the opportunity to acquire a majority stake of the company's stock and consequently take the control.[82]

The white squire defence is similar to white knight defense but the main difference is that the white squire is typically not interested in acquiring control of the target company. From the target's aspect, a large amount of the voting stock will be placed in the hands of a company or investor who doesn't intend to sell out to a hostile

[80] Yadav Ayush, (2011), "Hostile Takeovers and its Defense Tactics", Institute of Law, Nirma University, Ahmedabad, India

[81] Ibid

[82] Yang Erik and Zarin Samim, (Spring 2011), Bachelor thesis in "Mergers & Acquisitions: Hostile takeovers and defense strategies against them", Department of Business & Administration, International Business, School of Business, Economics and Law, University of Gothenburg

bidder. In an effort to ensure that the white squire won't become hostile, the white squire may need to agree in advance that it will remain with the target and not against it.[83] This agreement plays a key role for the successful function of this strategy and should be the first step by the target, for the scope of retaining its independency in any case.

PAC- MAN DEFENCE

Pac-man defence strategy follows the well-known quote: "Best Defence is a good Offence". This strategy occurs when the target company responds to the hostile bid with an offer to buy the hostile company. It is actually an attempt of the target company to scare off the wannabe acquirers, by even showing that the target is a majority stake and consequently, taking the control from them.[84]

For the best analysis of the Pac-Man defence, it is crucial to understand the rules of Pac-Man game. In this game, the player (target) is chased by ghosts and these ghosts are able to eliminate the target. Instead, if the player eats a power pellet, he gains the capability to eliminate the ghosts by simply turning round. Companies use a similar approach as a defense to a hostile takeover. The acquiring process begins when the acquirer purchases a large-scale of the target company stocks and aims to gain the full control of the target company. As a counter- strategy, the target- player reacts and purchases the acquirer's shares and even tries to get the control of the attacking company. The most important reason for the target company, to apply Pac-Man defence is to avoid the change of leadership and retain the control.[85]

However, Pac-Man defence strategy has some important drawbacks. First, it is an extremely expensive strategy, which might even increase debts for the target company and second, shareholders might be obliged to tolerate losses or lower dividends in the upcoming years.[86]

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[83] Gaughan A. Patrick, (2011), Active Antitakeover Defenses in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 218

[84] Yang Erik and Zarin Samim, (Spring 2011), Bachelor thesis in "Mergers & Acquisitions: Hostile takeovers and defense strategies against them", Department of Business & Administration, International Business, School of Business, Economics and Law, University of Gothenburg

[85] Prakash Pandey, (2014), "What Should You Know About Pac-Man Defense Tactic?", http://www.growingmoneyblog.com/what-should-you-know-about-pac-man-takeover-defense-tactic/

[86] Ibid

Bendix Corporation VS Martin Marietta case

A well known case of Pac-man defence case was established among Bendix Corporation, an automotive, industrial and aerospace company and Martin Marietta Corporation, an aerospace company[87]. In 1982, Bendix Corporation tried to take over Martin Marietta through purchasing a controlling amount of its stocks. Bendix Corporation became, on papers, the owner of Martin Marietta. However, Martin Marietta's management decided to sell off its Chemical department, Cement, and aluminum division. [88]Moreover, even though the company's earnings were weak, it decided to borrow the $1 billion needed to finance the acquisition of the Bendix Corporation. By the end of this extreme takeover, Allied Corporation and the United Technologies Corporation had both entered the picture.[89] Marietta was supported by the United Technologies Corporation, which made a counteroffer for Bendix and the takeover ended with an ultimate conquest by Allied. The battle ended with Bendix becoming a unit of Allied and Bendix shareholders would own stock in Allied. Marietta remained independent but due to its huge debt, the company's balance sheet was seriously detrimed. [90]

CROWN JEWEL DEFENCE

Crown Jewel Defence is a way for the target company to become less attractive for the unfriendly bidder. Through this strategy, the target either sells its most valuable assets (crown jewels), to a friendly third party (white knight) or it sells them but when the hostile company withdraws its bid, the assets are sold back to the target company at a fixed price, agreed in advance. A serious risk of this method is that the target company loses its most valuable assets and needs guarantees that it will take

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[87] Salmans Sandra, (1982), "Tumultuous takeovers saga ends: Allied and Bendix agree to merge", Business Day in the New York Times, U.S. Edition, https://www.nytimes.com/section/business,

[88] Prakash Pandey, (2014), "What Should You Know About Pac-Man Defense Tactic?", http://www.growingmoneyblog.com/ 2018

[89] "Origins of the Pac- Man defense", (1988), https://www.nytimes.com/section/business,

[90] Salmans Sandra, (1982), "Tumultuous takeovers saga ends: Allied and Bendix agree to merge", Business Day in the New York Times, U.S. Edition, https://www.nytimes.com/section/business,

them back.[91] Therefore, despite the fact that the "crown jewel" defence seems to be prima facie effective, it might be proven risky in a way, since the sale of the most valuable assets of the company jeopardizes its whole operation.[92]

CAPITAL STRUCTURE CHANGES

A target company may protect itself from a hostile takeover, through changes in its capital structure. There are four main types four bringing capital structure changes and those are the following:

1) Recapitalization plan

In general, a recapitalization plan leads the corporation in a totally different financial situation than it was before the plan. Important element of the recapitalization plan is that it allows the target to act as its own white knight. It usually evolves a large payment to the stockholders, which is usually financed through assumption of a big debt. The large increase to the company's debt makes the firm less attractive to potential hostile raiders and the recapitalization plan may defeat promptly the hostile bidder since the stockholders receive a value for their shares which is designed to be superior to the bidder's offer. [93]

2) Assumption more debt through bonds or a bank loan

In a few words, the assumption of more debt can be occurred directly, without a recapitalization plan. This additional debt can make the target riskier and less attractive for a potential bidder. This strategy may act as a *scorched earth defense,* since the additional debt may lead the target to bankruptcy.[94]

3) Issuing more shares

The target company, through issuing new shares, changes its capital structure since it retains the same debt level but its equity is increased. By issuing more shares, the

[91] Yang Erik and Zarin Samim, (Spring 2011), Bachelor thesis in "Mergers & Acquisitions: Hostile takeovers and defense strategies against them", Department of Business & Administration, International Business, School of Business, Economics and Law, University of Gothenburg
[92] Corelli Angelo,(2016), "Analytical Corporate Finance", Springer International Publishing, p.448
[93] Gaughan A. Patrick, (2011), Active Antitakeover Defenses in Mergers, Acquisitions, And Corporate Restructurings, fifth edition, John Wiley&Sons, Inc. Hoboken, New Jersey, pg 223
[94] Ibid pg 227

target complicates the hostile takeover, since the bidder is obliged to spend much more money for acquiring the majority of the stock.[95]

4) Buyback

A buyback is the purchase by the target of its own outstanding shares, which reduces the number of the available shares on the open market and in the same time their value is highly increased.[96] Through this way, the purchased shares are no longer available for potential bidders or arbitragers and the target becomes less attractive, since its available shares are much more expensive.[97]

LITIGATION

Last but not least, *Litigation* is the challenge of the hostile bid by the target company. Such challenges cause pressure to the hostile company, which has to be prepared for facing a legal injunction or a law suit. During the preparation of the bidder, the target has the time to create an additional defence strategy or to press the bidder to sweeten the bid in exchange of dropping the litigations. [98]

Litigation helps a target company to refute hostile attacks but is usually not effective as a long-term deterrent. There are three arguments that a target company can use to legally repel a bidder. First, *antitrust,* this is the argument according to which if the takeover effort is completed, the result combination will de facto violate antitrust laws. Second argument is the inadequate disclosure, which means that the bidder has not fully disclosed all available information and the final argument is fraud, which refers to the claim by the target according to which the attacker deliberately misrepresented facts for the scope of depriving stockholders of their rights. This last argument is difficult to be presented because it is rarely applicable and hard to be proved.

According to Jarell (1985), approximately one-third of all tender offers are challenged by the litigation defense. In a good sight, the real value of a law-suit is its

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[95] Ibid pg 229

[96] Ibid pg 230

[97] Investopedia,(2018), https://www.investopedia.com/

[98] Yang Erik and Zarin Samim, (Spring 2011), Bachelor thesis in "Mergers & Acquisitions: Hostile takeovers and defense strategies against them", Department of Business & Administration, International Business, School of Business, Economics and Law, University of Gothenburg

ability to extend the negotiation period before the target's board response. Most of the times, the extension of this negotiation period leads to results such as: the improvement of the initial bid and to the higher chance of a successful takeover. [99]

To sum up, the defence strategies that are analyzed in this chapter constitute only a part of the various strategies that exist and be adopted by companies, for facing hostile takeovers. Those referred are the most famous and can be applied either separately or combined. In this point it should be emphasized that the enactment of those strategies depends every time on the applicable national law.

THE EUROPEAN FRAMEWORK

The European Union intended to regulate takeovers for the scope of establishing an integrated capital market. The initial target was, to set up a single and efficient market of securities, which produces higher company value and lower costs of capital for European companies and at the same time to present higher yield to the shareholders.[100]

In a general framework, takeover regulations are designed to maximize shareholder value through encouraging beneficial takeovers and in the same time minimizing the risks of misbehavior by the directors, the majority of the shareholders and the acquirers. This can be achieved with potential rules such as: 1) imposing requirements on acquiring companies, target boards or the shareholders themselves, 2) establishing fiduciary duties to act in the best interest of all shareholders, 3) passing mandatory bids for all shares at the same price and 4) forcing board neutrality.[101]

In a few lines, the United States and Europe have adopted totally different frameworks for the hostile takeovers. For instance, the United States has given enough freedom to both acquiring and target companies, which means that the

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[99] Pearce John A. And Robinson Richard B. ,(2004), Article in "Hostile takeover defences that maximize shareholder wealth", *Business Horizons 47/5*

[100] Andras Kecskes and Vendel Halasz, (2014), paper in "Hostile takeover bids in the European Union: regulatory steps en route to an integrated capital market", Hungarian Academy of Science

[101] Magnuson William, (2009) Takeover Regulation in the United States and Europe: An Institutional Approach, 21PaceInt'lL.Rev.205, Available at: http://digitalcommons.pace.edu/pilr/vol21/iss1/6, pg 206

acquirer has the freedom to make an offer for any number of shares and the target board of directors may adopt defensive measures against this offer.[102]

In the European Union, the legal environment for hostile takeovers differs significantly among the Member States.[103] The principal source of law on takeovers is the EC Takeovers Directive which came into force on May 2004. Specifically, the Directive relates to takeover offers for companies whose shares have been admitted to trading on a regulated market. Those offers must be public offers to take control of a company admitted to a regulated market.[104]

Namely, the E.U. Directive on Takeover Bids (2004/25/EC) constitutes the legal framework which facilitates cross-border takeover bids. Moreover, the Directive is based on the EC Treaty chapter of freedom of establishment and it should in principle contribute to cross frontier corporate mobility through takeover bids. Despite that, due to the various legal and policy approaches of the Member States in the field of takeover regulation, the Directive ended up as a compromised version of a proposal that the Commission predicted that would be more effective in practice.[105]

THE MANDATORY BID RULE (article 5)

In comparison with the USA framework, the European Union has restricted significantly both the acquirer and the target company, in the takeovers field. First, the acquirer is obliged to make a bid for all the outstanding shares and not for any number it wants. This is the *mandatory bid rule (article 5),* which constitutes the first pillar of the E.U. Directive and this requirement stands totally different with the United States law, which has no requirement to buy unwanted shares.[106] The rule of mandatory bid is a remarkable achievement of shareholder interests in case of

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[102] Ibid pg 206

[103] Kirchner Christian and Painter Richard W.,(2000), "European takeover law: towards a European modified business judgment rule for takeover law", European Business Organization Law Review

[104] Alastair Hudson, (2013), Acquisitions in The Law of Finance, first edition, Sweet & Maxwell, pg 1066

[105] Papadopoulos, Thomas, The European Union Directive on Takeover Bids: Directive 2004/25/EC (2008). International and Comparative Corporate Law Journal, Vol. 6, No. 3, pp. 13-103, 2008.

[106]Magnuson William, (2009) Takeover Regulation in the United States and Europe: An Institutional Approach, 21PaceInt'lL.Rev.205, Available at: http://digitalcommons.pace.edu/pilr/vol21/iss1/6, pg 220

takeovers.[107] Under this rule, if an entity acquires control over a company, this entity is obliged to make a takeover bid for all the remaining voting securities of this company in an equitable price.[108] Specifically, article 5 of the E.U. Directive sets that: *"Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price as defined in paragraph 4."* And *"The percentage of voting rights which confers control for the purposes of paragraph 1 and the method of its calculation shall be determined by the rules of the Member State in which the company has its registered office."*[109]

The mandatory bid rule may also be seen as a "takeover- hostile "provision since it prevents the offeror from making a bid for some of the outstanding shares (partial bid) or from trying to buy shares in two stages and in two different prices (two-tier bid). As a result, the mandatory bid rule raises the costs for an acquisition since the offeror is obliged to make a bid for all the outstanding shares and this may act as a deterrent to both friendly and hostile takeovers. [110]

In conclusion, the offeror, due to the mandatory bid rule, may avoid bidding for a corporation, since the costs are raised and after the evaluation the whole acquisition may be less profitable for the acquirer.

THE BOARD NEUTRALITY OR NON-FRUSTRATION RULE (article 9)

The Directive restrains the directors' response in case of a bid, with a strict rule on *neutrality*. Specifically, article 9 of the Directive defines that: the management board should not make *"any action, other than seeking alternative bids, which may result in the frustration of the bid",* without the prior authorization by the general meeting of shareholders. Except for the exclusion of seeking alternative bids, the target board of directors has the competence to choose not to take any defence measures for the

[107] Andras Kecskes and Vendel Halasz, (2014), paper in "Hostile takeover bids in the European Union: regulatory steps en route to an integrated capital market", Hungarian Academy of Science

[108] Clerc Cristophe and Valiante Diego, (2012), "A Legal and Economic Assessment of European Takeover Regulation", Marccus Partners and Centre for European Policy Studies, pg 52

[109] Council Directive 2004/25, art 5(1) and art 5(3), 2004, O.J. (L142) (EC)

[110] Clerc Cristophe and Valiante Diego, (2012), "A Legal and Economic Assessment of European Takeover Regulation", Marccus Partners and Centre for European Policy Studies, pg 53

scope of frustrating the bid unless these measures are authorized by the shareholders. [111] This is because it is considered a fundamental principle that the future of the company has to be decided by its owners and not its managers.[112] This principle of *shareholder decision making* is directly related to the shareholder protection rationale.[113]

In practice, if an EU member state or the shareholder's meeting of the target company opted to impose the restrictions on frustrating actions of the target's management board[114], which are set in Article 9 of the Directive, the management board is permitted to make only specific actions, in the period from the time the board receives the announcement concerning the takeover offer until the result of the offer is made public or the offer lapses. The permitted actions are the following:

- Searching for a white knight
- Actions within the ordinary course of business
- Actions beyond the ordinary course of business, if the decision is taken before the initiating of the time period which is described above and has not yet partly or fully implemented
- Any actions if those are authorized by a shareholder's meeting taking place after the beginning of the "suspicious" time period. For the scope of facilitating the prior authorization, the EU member States may adopt rules allowing a shareholder's meeting to be called a short notice (the minimum period is two weeks)[115]

This strict framework that the Directive provides, leads to a substantial key point for taking defensive measures when facing hostile takeovers. The board is obliged to inform the shareholders before any movement and that is for sure a restrictive factor, especially in cases where the shareholders have actually incited the takeover.

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[111] Ibid pg 207

[112] Bolkestein Frits, (2002), public speech about the "New proposal on takeover bids", European Commissioner in charge of Internal Market and Taxation, Brussels

[113] Papadopoulos Thomas (2008), Legal Aspects of the Breakthrough Rule of the European Takeover Bid Directive, University of Cyprus, Department of Law

[114] According to article 12 (1) of the EU Directive on Takeover Bids (2004/25/EC), Member States have the option not to require companies which have their registered offices within their territories to apply Aricle 9 (2) and (3) and/or Article 11.

[115] Cascante Christian and Tyrolt Jochen, European Directive Takeover Guide, Gleiss Lutz, Germany

In most of the cases this is practically impossible, since the notice and preparation period for a general shareholder's meeting is too long.[116]

THE BREAKTHROUGH RULE (article 11)

Article 11 of the EU Directive on Takeover Bids (2004/25/EC) lays down that: "*Multiple-vote securities shall carry only one vote each at the general meeting of shareholders which decides on any defensive measures in accordance with Article 9".* This one-share-one-vote system, also known as the *breakthrough rule*, guarantees that shareholders will still have to compete for control in case of an offer, since they won't have the opportunity to take advantage of multiple voting rights and block a hostile tender offer. [117]

"Restrictions on voting rights provided for in contractual agreements between the Offeree Company and holders of its securities or in contractual agreements between holders of the oferee company's securities entered into after the adoption of this Directive, shall not have effect at the general meeting of shareholders which decides on any defensive measures in accordance with Article 9." This rule expresses the proportionality principle, since according to the rule: contractual and property rights which inhibit legitimate bids should be broken through and the shareholders gain freedom based on this redistribution of rights[118]. This is also known as "one share-one vote" principle and aims at preventing recourse to any pre-bid system of shares, which violates this principle, regardless of the class of the shares.[119]

Serious deficiency of the "breakthrough" rule is that it only emphasizes to restrictions on rights and doesn't predict something for rights that have been freely

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[116] For instance in Germany this time period is more than two months, Christian Kirchner and Richard W. Painter, 2000, "European takeover law: towards a European modified business judgment rule for takeover law", European Business Organization Law Review

[117] Magnuson William, (2009) Takeover Regulation in the United States and Europe: An Institutional Approach,21PaceInt'lL.Rev.205 , Available at: http://digitalcommons.pace.edu/pilr/vol21/iss1/6

[118] According to the proportionality principle, the degree of risk/ reward which the shareholders take should determine the degree of control to be exercised by them. Thus the greater the shareholder's stake in the company in terms of his exposure to the company's success or failure, through his holding in the risk- capital or general cash-flow rights, the greater his voice should be in determining the manner of its control. Papadopoulos Thomas (2008), Legal Aspects of the Breakthrough Rule of the European Takeover Bid Directive, University of Cyprus, Department of Law

[119] Papadopoulos Thomas (2008), Legal Aspects of the Breakthrough Rule of the European Takeover Bid Directive, University of Cyprus, Department of Law

negotiated and are enshrined in different classes of shares. This is a point that should be predicted and directed, since taking away rights that are freely negotiate by the shareholders, without compensation for the loss or without taking the risk of undesirable economical consequences, maybe will raise legal issues. [120]

THE RECIPROCITY RULE (article 12)

It is crucial that, those provisions regarding *board neutrality* and the *breakthrough rule*, which are mentioned above, are optional and member states are allowed by the Regulation to opt out and not apply them (Art. 12 par 3 of the Directive). Even if a Member State decides not to make these rules mandatory, it cannot prevent companies from adopting them voluntarily. In this case, the decision for the adoption of those rules must be taken in turn by the shareholder's meeting and can be reversed in the same manner. [121]

Moreover, the EU member States may exempt companies which apply Article 9(2) and (3) or/and Article 11, from applying them if there is no *reciprocity*, that is if the bidder (or a company controlled directly or indirectly, by the bidder) does not apply the relevant Article. There are different aspects of how this reciprocity rule can also be applied in case of a non- EU bidder but the Directive does not specify which would be the solution in this case. [122]

Consequently, irrespective of its strict framework, the Directive retains its flexibility by giving the member states the right to make choices according to their policy. Conversely, this optional character of the "board neutrality" rule and the "breakthrough" rule has been characterized as a serious deficiency of the Directive, since it doesn't assist for the initial scope of creating a unified European system in the field of takeover bids. Member States have the opportunity to adopt a different

[120] Bolkestein Frits, (2002), public speech about the "New proposal on takeover bids", European Commissioner in charge of Internal Market and Taxation, Brussels

[121] Clerc Cristophe and Valiante Diego, (2012), Provisions relating to takeover defences in "A Legal and Economic Assessment of European Takeover Regulation", Marccus Partners and Centre for European Policy Studies, pg 77

[122] Cascante Christian and Tyrolt Jochen, European Directive Takeover Guide, Gleiss Lutz, Germany

approach and due to this, policy matters arise. In conclusion, for a unified European system in the field of takeover bids, changes seem necessary.

PROPOSALS FOR A UNIFIED EUROPEAN SYSTEM

In this part of my paper I will make some proposals that in my aspect would contribute for the initial scope of the 2004/25/EC European Directive, namely the creation of a unified system among Member States, in the takeovers field. First, the Directive, regarding the *mandatory bid rule* (Article 5), as above mentioned, does not specify what share of the capital and voting rights is needed for control and not even a method of calculation is predicted. The percentage of voting rights which confers control and the method of its calculation are left to be determined by the Member State in which the company has its registered office.[123] This lack of defining the control threshold and price definition, doesn't contribute to a unified system of minority shareholder protection, which is the basic scope of the mandatory bid rule.[124]

My proposal for a unified minority protection system is to be at least determined a range of voting rights that should be used for gaining the control and also a system for calculation to be directed. This would lead the Member States to have similar regulation regarding the control threshold, without serious deviations. Those matters should be directed and a framework should be predicted by the Directive, regarding the control threshold and the calculation method adopted, for the scope of creating a unified minority shareholder protection scheme, in the European Union.

Moreover, due to the strict *board neutrality rule* (Article 9) the board of the target corporation doesn't have the power to react directly and effectively against a hostile takeover bid, since the decision of taking defence measures against a hostile takeover is solely in the hands of the shareholders. Since the shareholder's meeting sometimes cannot be called until after the tender offer has expired, the

[123] Ibid

[124] Papadopoulos, Thomas, The European Union Directive on Takeover Bids: Directive 2004/25/EC (2008). International and Comparative Corporate Law Journal, Vol. 6, No. 3, pp. 13-103, 2008.

shareholders are obliged to decide and act individually and not in co- ordination. [125]
A proposal as a solution on this matter, might be to be predicted by the Directive that under specific circumstances and if the future of the company is threatened, the board has the ability to decide whether to adopt defense measures or not and this decision will be examined by the general meeting, afterwards, with serious consequences for the management.
The initial scope of the EU Directive on Takeover Bids 2004/25/EC was the harmonization of the different legal systems in Europe, referred to the takeover bids. In my aspect, for the fulfil of this aim, the *reciprocity rule* and the opt-out possibility for Member States, should be restricted, since those possibilities result to many different combinations of the legal obligations that the Directive sets. Since board neutrality and the breakthrough rule consist the hard core of the Directive, opting out of those rules leads to a totally different approach, in the field of the takeovers and consequently to different policy principles.
This is a key point regarding the defence measures, since this optional character of the two rules, leads to different approaches regarding the board's ability to adopt defense strategies. Matters arise, since during a hostile takeover among two corporations which have their registered offices in different EU countries, national law defines the conditions according to which companies which apply Article 9 (2) and (3) and/ or Article (11) are exempted from applying them if they became subject of an offer launched by a company which does not apply the same Articles as they do (Article 12 (3)). In my aspect, these conditions should be predicted from the beginning by the Directive, for the scope of harmonizing the takeover bids field, since if these conditions are predicted by national law each time, serious differentiation will be created among corporations.
Moreover, as analyzed in this thesis, the proactive measures of a defence strategy have a key role, for the defence plan of the acquired corporation. In practice, if the national law sets strict conditions for opting out from the breakthrough rule, the target company finds itself in a weak position and becomes vulnerable if the bidder

[125] Kirchner Christian and Painter Richard W., (2000), "European takeover law: towards a European modified business judgment rule for takeover law", European Business Organization Law Review

doesn't apply the rule and therefore, the board has not the freedom to use pre bid defences, such as poison pills, without the shareholder's prior authorization.
Moreover, the Directive should point out what should be the approach of a corporation, regarding the reciprocity rule, when the bidder comes from a non- EU country. This is a serious matter, since nowadays international business among corporations, is an existing and usual phenomenon.

Conclusion

In general, defence strategies against hostile takeovers are the methods which aim in protecting the company as well as its shareholders interests. Also, it is a widely shared belief that hostile takeovers allow the shareholders to realize the best price of their investment. Moreover, it is said that these takeovers are a way of transferring control from an inefficient management to an efficient one, and that economic efficiency is promoted.[126] Someone would ask then what the rationale of adopting defence strategies is.
The answer is that not all the hostile takeovers have a profitable result for the company or even an advantageous side. There are cases in which the target company needs to be protected and the management board needs to escape from the shareholders' plans. Some hostile takeovers may promote efficiency, some may result in a misallocation of economic resources and some may be neutral in terms of economic efficiency.[127] This differentiation and complexity of every situation needs to be confronted with different defensive methods which constitute various strategies.
In my point of view, defence measures should be taken only after serious evaluation and if the hostile takeover threatens the corporation's economic interests and not only the management interests. This decision should be taken through the process of a unanimous voting by the shareholders in cooperation with the management board, and not without them, since the management has a clear and uninterrupted picture of the company's operation.

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[126] Law Mantra, descriprion by Mohit Mittal and Harsh Sharma, (2017),"Analysis on Combating Hostile Takeovers", LAW MANTRA, National Monthly Journal, I.S.S.N 2321 6417
[127] Ibid

In the end, defence methods are a matter of policy and the EU Regulation leaves enough space for the Member States and indirectly to the interested parties, the corporations, to be independent. Specifically, the EU Directive on Takeover Bids 2004/25/EC, as above mentioned, through the reciprocity rule (Article 12) gives to the Member States the discretion to opt- out from the board neutrality rule and the breakthrough rule but in the same time the obligation to grant companies which have their registered offices in their territory the option of applying these rules.

In any case, the selection of a defence strategy against a hostile takeover is a crucial decision and a matter of policy. The target must be fully prepared for facing unfriendly bids and in the same time remain flexible in responding to various takeover techniques. For sure, there is no "One size fits all" defence strategy for the target to become full-proof against all potential bids. Prerequisite for a well structured defence strategy is a review of the takeover environment[128], circumstances and exogenous factors that may affect the whole acquisition.

[128] Manish Sharma, (2016), "Hostile takeovers and Defense Strategies-Part-II", https://www.simplilearn.com/hostile-takeovers-and-defense-strategies-in-ma-part-ii-article

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