

M&A Hotline

April 28, 2022

MUSK POPS TWITTER'S POISON PILL WITHOUT ANY SIDE EFFECTS!

It is public knowledge that Elon Musk ("Musk"), the billionaire founder and chief executive of Tesla and SpaceX, has had a tempestuous streak even up until Musk's recent bid to acquire the social media platform, Twitter Inc ("Twitter"). A passionate and innovative entrepreneur that Musk is known to be, started acquiring shares of Twitter from the public markets from January 31, 2022 onwards till April 1, 2022¹ to the extent that he accumulated shares aggregating to over 9.2% making him the largest outside shareholder. A filing² with the US Securities and Exchange Commission³ mentioned that he was holding a passive stake in Twitter. Twitter's stock price surged by about 30% on this news.

MUSK'S TAKEOVER OFFER

Following Musk's turning down of a seat on the board of Twitter⁴, Musk announced an offer to take Twitter private with a deal valued at USD 43 billion which translated to USD 54.20 per share in cash⁵. Although there were reports that the takeover offer was unwelcome⁶, Twitter stated that the proposal would be reviewed by Twitter's board and any response would be in the best interest of all Twitter shareholders⁷. Following his offer, Musk announced that he has readied a war chest of USD 46.5 billion. Musk arranged the financing through a mix of debt and equity after bringing on Morgan Stanley as his adviser, which enabled him to get a dozen banks to commit USD 25.5 billion in debt financing and Musk himself pledged another USD 21 billion in equity financing⁸.

TWITTER'S POISON PILL

What followed in response to the proposal from Musk was the induction of the poison pill by Twitter in order to shield itself against Musk's potential hostile takeover. Twitter set up a shareholder rights plan enabling the existing shareholders to be entitled to purchase additional shares at a 50% discount, in case any party acquires 15% of the Twitter's stock without prior approval⁹, with the intent of reducing the likelihood of any person gaining control of Twitter without providing the board sufficient time to make informed judgments. Twitter's poison pill would have a limited life-span of 1 year and would 'expire' on April 14, 2023. The meat of Twitter's announcement of the shareholders rights plan is as follows:

*"Under the Rights Plan, the rights will become exercisable if an entity, person or group acquires beneficial ownership of 15 per cent or more of Twitter's outstanding common stock in a transaction not approved by the board. In the event that the rights become exercisable due to the triggering ownership threshold being crossed, each right will entitle its holder (other than the person, entity or group triggering the rights plan, whose rights will become void and will not be exercisable) to purchase, at the then-current exercise price, additional shares of common stock having a then-current market value of twice the exercise price of the right."*¹⁰

Effectively, if one held 100 shares in Twitter, he/she would be entitled to acquire 100 more shares at 50% discount, which by operation of the shareholders rights plan meant that every shareholder of Twitter except Musk, would be able to double the number of shares they own – this evidently is a very profitable scenario for the shareholders of Twitter.

TWITTER'S SURRENDER TO MUSK

Interestingly, couple of days back, Twitter announced that it has accepted Musk's proposal for its acquisition by an entity wholly owned by Musk¹¹. Under the agreed proposal each shareholder of Twitter would receive USD 54.20 in cash for each share of common stock and eventually Twitter becoming a privately held company upon completion of the entire transaction.

Musk while making his offer also claimed that it was his best and final offer. Twitter's board may have also failed to increase shareholder value as evidenced by the stock's price history - On the day of its initial public offering in 2013, Twitter stock was trading at USD 44.90 and its price had surged 4.19 per cent to reach USD 50.98 in after-hours trading in New York on the news that negotiations had begun between the two parties and an announcement was imminent¹². Perhaps, the Board also observed that the price has been flat for about 10 years and shareholders could make a very strong argument that Twitter management has had more than enough time to increase shareholder value — and they didn't or couldn't.¹³

Against this backdrop, we analyse whether a 'poison pill' strategy is an effective mechanism to thwart hostile

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DECODING THE POISON PILL IN THE USA

The use of the poison pill strategy in the face of hostile takeovers was devised in 1982 by Martin Lipton, a star M&A lawyer in New York. The poison pill was created to stave off an unsolicited, non-binding proposal to acquire a company.¹⁴

In 1985, *Moran v. Household International, Inc.*¹⁵, was the first case in which the Delaware Supreme Court upheld the poison pill as a legitimate takeover defence mechanism. A poison pill¹⁶ is a mechanism used to combat hostile takeovers wherein the target company issues share warrants to the existing shareholders at a substantial discount if the hostile acquirer buys shares of the target company beyond a certain threshold, typically between 10%-15%. The different types of poison pills that are used by US corporations are flip in and flip over.

- Under the flip in poison pill, in the event of a hostile takeover, the target company issues share warrants to the shareholders that entitle them to purchase shares of the target company at a considerable discount to the prevailing market price of the share. The rationale behind this mechanism is to drive down the share value of the target company for the hostile acquirer and dilute the ownership interest of the hostile acquirer to such an extent that any further acquisitions made becomes an expensive affair for acquirer.
- Under the flip over poison pill, the target company's shareholders are entitled to purchase the hostile acquirer's shares, i.e., in the surviving/merged entity at a discount.

Undoubtedly, the poison pill has been used as a formidable defence for US corporations to curb hostile takeovers. In 2008, Yahoo! had used the poison pill successfully to curb the hostile takeover attempted against it by Microsoft.¹⁷ Similarly, in 2012, Netflix had adopted the poison pill strategy to curb a possible hostile takeover by billionaire investor Carl Icahn.¹⁸ Almost 100 poison pills were adopted by US companies in the year 2020 following the onset of the pandemic in March 2020.¹⁹

In light of the widely used defence of the poison pill against hostile takeovers, it becomes pertinent to understand whether the poison pill can be adopted by Indian companies to combat hostile takeovers.

POISON PILL IN INDIA – A LEGAL PERSPECTIVE

The poison pill is not an unfamiliar concept in the Indian context. Significant number of the Indian companies even until now are promoter driven or closely held and managed as a family business. Indian corporates and securities laws do not permit most of the takeover defences used in other jurisdictions. Consolidating promoter shareholding thereby making a company hostile takeover-proof, is a strategy some corporates have adopted. An interesting usage of the same can be seen by the well renowned Tata group which uses the "desi" version of the poison pill which can be referred to as 'brand pill' which is included in the articles of association of various group companies (pursuant to various brand licensing agreements) and which would operate to dis-incentivise a potential takeover bid by an acquirer such that the target company becomes disabled or no longer authorised to use the brand of the Tata group (which as is well known to have indisputable goodwill and image attached to the brand name) upon acquisition of the target company by the acquirer and indirectly lowering the value of the target significantly and making the potential takeover un-attractive.

The most recent successful hostile takeover in the Indian context is the acquisition of Mindtree Limited ("**Mindtree**") by Larsen and Toubro Limited ("**L&T**") in 2019. The peculiar shareholding pattern of Mindtree was one of the key reasons for the hostile takeover to be successful. The promoter's stake in Mindtree was only 13.32%. In order to combat the hostile bid of L&T, Mindtree announced an increase in shareholder dividends, proposed a buyback of shares and contended that Mindtree's work culture is not in line with that of L&T. However, none of these defence mechanisms proved useful. L&T began the hostile takeover by buying out the stake of V.G. Siddhartha, the largest shareholder in Mindtree and acquired 15% stake from the open market. These acquisitions triggered an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Code**") which enabled L&T to complete its hostile takeover. A detailed dissection carried out by us of the entire acquisition of Mindtree by L&T is available [here](#).

Unlike in the US context, the Indian laws do not allow companies to issue share warrants in case of a hostile takeover or if the (hostile) acquirer breaches certain acquisition thresholds. Further, the share warrants issued by companies do not enable shareholders to buy shares at a discount to the prevailing market price on account of restrictions under the Companies Act, 2013 or the SEBI (Issue of Capital and Disclosure Requirements), 2018 and Foreign Exchange Management Act, 1999 and rules made thereunder.

WHAT IF TWITTER WAS AN INDIAN LISTED COMPANY?

Had Twitter been a listed entity in India, Musk would have been obligated to undertake an open offer under the Regulation 3 and Regulation 4 of the Takeover Code and seek delisting²⁰ of Twitter by making a delisting offer. The principal condition for pursuing such an open offer pursuant to this provision is the disclosure of the intent – i.e. the intent of the acquirer to delist the target company, (a) at the time of announcement of the open offer and (b) at the time of making the detailed public statement. The most critical element of the delisting process is (i) the price at which the shares are tendered by shareholders and also (ii) securing sufficient interest in the delisting offer from the open market – i.e. public shareholders.

CONCLUSION

A hostile takeover is certainly not an easy affair for the target company but ensures that the existing management of the target company is (and remains) accountable to the shareholders and always keeps the interest of the shareholders at the forefront. The existing takeover laws in India are not as conducive as takeover laws in the west for hostile takeovers. In the interest of better governance and accountability, time has come for Indian regulators to relook at the existing takeover laws and create a more conducive legal, regulatory and tax framework for hostile takeovers in India.

You can direct your queries or comments to the authors

¹ <https://timesofindia.indiatimes.com/business/international-business/a-timeline-of-elon-musks-takeover-of-twitter/articleshow/91088717.cms>

² Shareholders holding 5% or more of a public company's stock and intending to remain "passive" i.e. those who don't seek to influence or change control of a company are required to file a shorter form (Form 13G) with the Securities and Exchange Commission. Shareholders who have strategic interests otherwise targeting board seats or certain management change typically file a longer form (Form 13D) within 10 days of acquiring their stake.

<https://www.livemint.com/companies/people/elon-musk-s-passive-stake-in-twitter-belies-his-big-influence-11649118881405.html>

³ <https://www.cnn.com/2022/04/04/twitter-shares-soar-more-than-25percent-after-elon-musk-takes-9percent-stake-in-social-media-company.html>

⁴ <https://economictimes.indiatimes.com/tech/technology/elon-musk-turns-down-twitter-board-seat-ceo-parag-agrawal/articleshow/90770231.cms>

⁵ <https://www.bloomberg.com/news/articles/2022-04-14/elon-musk-launches-43-billion-hostile-takeover-of-twitter>

⁶ <https://www.theverge.com/2022/4/14/23025537/twitter-board-shareholders-elon-musk-hostile-takeover-poison-pill>

⁷ <https://www.bloomberg.com/news/articles/2022-04-14/elon-musk-launches-43-billion-hostile-takeover-of-twitter>

⁸ https://www.business-standard.com/article/international/brash-and-fast-how-unwelcome-suitor-elon-musk-took-over-twitter-122042600840_1.html

⁹ <https://www.livemint.com/news/world/twitter-adopts-poison-pill-to-block-elon-musk-takeover-11650040903382.html>

¹⁰ <https://www.thenationalnews.com/business/money/2022/04/25/twitters-poison-pill-what-is-it-and-can-it-block-elon-musks-takeover-bid/>

¹¹ <https://www.cnn.com/2022/04/25/twitter-accepts-elon-musks-buyout-deal.html>

¹² <https://www.thenationalnews.com/business/money/2022/04/25/twitters-poison-pill-what-is-it-and-can-it-block-elon-musks-takeover-bid/>

¹³ Ibid

¹⁴ <https://www.thenationalnews.com/business/money/2022/04/25/twitters-poison-pill-what-is-it-and-can-it-block-elon-musks-takeover-bid/>

¹⁵ 500 A.2d 1346 [1985]

¹⁶ <https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27094.20.pdf>

¹⁷ <https://www.forbes.com/sites/amiyatoshpumanandam/2022/04/18/does-twitters-poison-pill-adoption-really-matter/?sh=22787d7e10d8>

¹⁸ <https://www.thenationalnews.com/business/money/2022/04/25/twitters-poison-pill-what-is-it-and-can-it-block-elon-musks-takeover-bid/>

¹⁹ <https://www.lexology.com/library/detail.aspx?g=db26ae52-2757-4d4b-a4d8-2d3d13f9da43>

²⁰ Regulation 5A of the Takeover Code

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