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The Dutch Poison Pill: How is it Different from an American Rights Plan?

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During the spring and summer of this year, the so-called "Dutch Poison Pill" made it to the front pages of the business sections of *The New York Times*[1] and *The Wall Street Journal*.[2] The Dutch Poison Pill received this extraordinary attention because of its use by Mylan N.V. ("Mylan"), a NASDAQ-quoted Dutch public limited liability company (or, "Dutch N.V.") to ward off an unsolicited takeover bid by the Israeli pharmaceutical company Teva Pharmaceutical Industries Ltd. ("Teva"). Mylan, which had previously been a Pennsylvania corporation, became a Dutch N.V. in early 2015 through an inversion, which involved merging Mylan into a newly created Dutch acquisition vehicle that also acquired certain non-U.S. businesses of Abbott Laboratories.

More recently, Mylan's Dutch Poison Pill and the company's other defenses against Teva have been credited with inspiring an October 27, 2015 change in the SEC rules (actually, a rule interpretation) which requires a company that does an inversion through a newly created acquisition vehicle to have a separate shareholder vote on all the material corporate governance changes that it implements as part of the transaction. The press has reported that a major factor behind this guidance was the SEC's belief that when Mylan shareholders approved the Mylan inversion, they did not receive adequate disclosures of the implications of becoming a Dutch N.V., including the potential use of a Dutch Poison Pill and the broadening of the directors' fiduciary duties to include all stakeholders.[3]

This article explains how a Dutch Poison Pill works and describes the role that Dutch courts have played in overseeing the use of the Dutch Poison Pill against activist shareholders and hostile bidders.

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[1] "The Unintended Twist of Tax Inversions"; *New York Times DealBook*. April 24, 2015. "Mylan's Dutch Takeover Defense Is in Nasdaq's Hands"; *New York Times DealBook*. June 11, 2015.

[2] "Mylan Is Too Big a Pill for Teva"; *Wall Street Journal*. April 21, 2015. "The Rise of the 'Stichting,' an Obscure Takeover Defense"; *Wall Street Journal*. April 22, 2015.

[3] "Regulators Unbundle Some Attracts of Mergers"; *New York Times DealBook*. November 3, 2015. Before the inversion the Mylan directors had the right under Pennsylvania law to consider stakeholder interests, but were not obligated to act in the interests of stakeholders other than shareholders.

The Dutch Poison Pill has a superficial resemblance to a U.S. pill, in that both involve grants of options to acquire preferred stock. However, the inner workings of a Dutch Poison Pill are fundamentally different from an American Pill. In the Dutch Poison Pill the option (to subscribe for preferred stock at a much lower per-share price than the market price for the ordinary shares) is typically granted to a Dutch foundation (*stichting*),[4] rather than to the company's shareholders. While the preferred stock that is the subject of the option has insignificant financial value, it typically carries voting power equal to all of the company's outstanding ordinary shares. Therefore, the Dutch Poison Pill deters hostile bidders and activists, not by threatening them with economic dilution, but by preventing them from acquiring voting control or electing allies to the board.

The use of a Dutch Poison Pill against a hostile bidder or activist involves the following steps:

1. **Authorization of Preferred Stock.** To create a Poison Pill a Dutch N.V. must have a class of preferred stock with appropriate legal and economic rights authorized in its Articles of Association.
2. **Shareholder Resolution.** Under Dutch law, every issuance of shares, including the issuance of the preferred stock utilized in a Poison Pill, requires a shareholder resolution. However, the shareholder resolution can be adopted prior to the time shares are issued to the public (*i.e.*, before the Dutch N.V. goes public), and that resolution can delegate authority to the board to issue shares for a period of up to five years. This was the pattern followed by Mylan, which had the necessary shareholder action taken prior to the time shares were issued to the public in the Mylan inversion transaction. As a result, when Teva made its unsolicited bid for Mylan, the Mylan board was in a position to put a Poison Pill in place without any further shareholder action.[5] Mylan's situation at the time of the Teva bid was not unprecedented (in the sense that the board had not yet acted on its authority before Teva's intentions became known), but typically the call option is granted before Dutch N.V. goes public and the Poison Pill is already in place when the company faces a "threat."
3. **Grant of the Call Option.** If a shareholder resolution is in place, a Dutch N.V. can create the Poison Pill at any time by granting a call option to acquire a sufficient amount of preferred stock to exercise voting control over the company. Typically, the call option is granted to a *stichting*, which is entitled, in its sole discretion, to exercise this option any time it determines that the continuity and best interests of the Dutch N.V. are threatened. The company arranges for the establishment of the *stichting* and the appointment of

[4] A *stichting* is a private foundation organized under Dutch law. It is a self-contained legal entity that has no members or shareholders. Accordingly, no one "owns" a *stichting*, and it cannot be "transferred," but it can be merged or converted into another legal entity. There is only one required corporate body: the board of directors. All powers within the *stichting* are normally vested in its board of directors, and subsequent (new) board members are often appointed by the incumbent board members ("co-optation"). This co-optation designed to "insulate" the *stichting* from (unwanted) outside pressures. The *stichting*'s board of directors also decides on any amendment of the *stichting*'s articles of association, on a conversion, merger or dissolution. Board members are not accountable to anyone for their actions, but can in certain rather limited circumstances be removed by a Dutch court. The purposes of the *stichting* must be set out in its articles of association and do delineate the board of directors' powers. Typically, the board of this type of *stichting* has among its members former CEOs of Dutch "Blue Chips" and one or more law professors or (retired) corporate lawyers. There are no nationality or residency requirements for board members.

[5] It was, and also today it remains, unclear whether or not the issuance of the *preference shares* would require further shareholder approval based on the NASDAQ listing rules, *i.e.*, the rule known as the "20 percent rule." (It is our understanding that NASDAQ continues to refuse to take a position on this issue.) See also the June 11, 2015 publication in the *New York Times DealBook* referenced in footnote 2.

members to its board at the time the option is granted, and the ability of the company to use the Poison Pill to protect itself against a hostile bidder or activist is dependent on having a *stichting* board that shares the same concerns as the board of the Dutch N.V.

4. **Exercise of the Call Option.** It is unusual for a *stichting* to exercise its call option. Looking back over the last 15 years, we know of only four instances in which this step been taken: Stork, ASMI, KPN and Mylan (all discussed below). Normally, the *stichting*'s legal right to exercise the call option is sufficient to ward off the hostile bidder or hold the activist at bay. Under Dutch law, if the *stichting* exercises the call option, it must pay at least 25% of par value at the time it acquires the shares from the company. Because the preference shares have very low par value (often as low as one eurocent), this upfront payment is typically in the low millions of euros, which the *stichting* finances, along with its legal fees and administrative costs, by taking out a bank loan. The economic return on the preference shares is limited to a fixed dividend, which is set at a level that enables the *stichting* to service the bank loan. As a result for a relatively small purchase price, financed entirely with a bank loan, the *stichting* can get half the voting rights in a major corporation like Mylan, which has a market cap in excess of $20 billion.

With the ability to acquire approximately 50% of the voting power (on a fully-diluted basis) of the Dutch N.V. at any time, the *stichting* is able to block both an unsolicited takeover bid and an attempt by an activist to replace members of the board. While a hostile bidder could go ahead and acquire a majority of the ordinary shares in the face of a Dutch Poison Pill, these shares would not provide voting control if the *stichting* exercised its call option, and therefore a bidder is highly unlikely to close on an offer for the ordinary shares while a Dutch Poison Pill is (or any preference shares issued remain) in place. Similarly, an activist seeking to change the composition of a Dutch N.V.'s board would recognize that it cannot succeed as long as it is opposed by a *stichting* with a call option on preferred shares with (close to) half the stockholder voting power.

Balancing the tremendous defensive power of the Dutch Poison Pill is the possibility that a court will order any preference issued to be redeemed or to remain "non-voted" by the *stichting*. As a contractual matter, the call option held by the *stichting* is not limited in time, and typically cannot be unilaterally revoked either by the Dutch N.V., its board of directors, or its shareholders. However, in activist scenarios, the Dutch courts have in the past forced the company and the *stichting* to reach a compromise with an activist shareholder. The principle that the court applied in that instance resembled the one that the Delaware courts have articulated under the *Unocal* doctrine. The use of a defensive measure must be reasonable and proportionate to the threat it as addressing.

However, a recent Dutch Supreme Court decision has called into question the authority of courts to interfere with the exercise of voting power by the *stichting*. These issues are unresolved in part because the Netherlands, unlike Delaware, has only a few reported cases involving Poison Pills, and the opinions in those cases provide limited guidance on how the Dutch courts will deal with the Dutch Poison Pill in practice.

The best way to get an understanding of how the Dutch Poison Pill works in practice and how the courts have dealt with this defensive measure is to consider the four instances (in the last 15 years) in which a *stichting* has exercised its call option, *i.e.*, Stork, ASMI, KPN and Mylan:

Stork

In Stork (2007), two activist shareholders wished to change the composition of Stork N.V.'s supervisory board (which, in turn, supervised and appointed Stork's management board)[6] in order to force the company to divest its non-core businesses. In response to these shareholders seeking this supervisory board change, the *stichting* exercised its call option. The shareholders went to the Enterprise Chamber[7] of the Amsterdam Court of Appeals to challenge the *stichting*'s action. In this lawsuit, called a "management enquiry proceeding," the court (i) held that since the call option agreement between Stork and the *stichting* only permitted an exercise to ward off a hostile bidder or corporate raider, the call option could not be utilized against an activist and, consequently, the preference shares had to be cancelled, (ii) held that since the boards had to set corporate strategy and not the shareholders, the shareholders could not seek supervisory board change to "push through" the implementation of corporate strategy desired by the shareholders especially at a time, as happened in this case, when the shareholders were still in discussion with the boards over Stork's corporate strategy, and (iii) appointed three additional "neutral" directors to the supervisory board specifically entrusted with healing the poisoned relationships between the two boards and the activist shareholders. In other words, the court ruled partly in favor of the activists by holding that the scope of this particular call option agreement did not permit the option to be exercised against an activist (as distinguished from using the option against a hostile bidder, which was clearly covered by the wording of the call option agreement); and partly in favor

[6] A large number of Dutch N.V.s have a two-tier board structure, in which the supervisory board, solely comprised of non-executive directors, supervise the management board, solely comprised of executive directors, which latter board is entrusted with the day-to-day running of the Dutch N.V.'s business. And in certain of these two-tier board structures the supervisory board appoints and dismisses the members of the management board, while the members of the supervisory board are appointed and dismissed by the general meeting of shareholders.

[7] The Enterprise Chamber is a "special business court" in terms of its unique jurisdiction, specialized power of enquiry, expertise and composition. Contrary to other Dutch courts (including the other divisions of the Amsterdam Court of Appeals), its bench is a mix of lawyers and non-lawyers (with the latter often being former Dutch CPAs, tax advisers or forensic accountants). All members of this court, like all other Dutch courts, are formally appointed by the Dutch government, as opposed to elected by the public. Although part of the Amsterdam Court of Appeals, the Enterprise Chamber is the court of first instance (initial trial court) under the provisions governing the so-called "management enquiry proceedings," which are the proceedings that parties rely upon to challenge certain corporate actions. Section 2:345 of the Dutch Civil Code provides that management enquiry proceedings must focus on "*the policy and conduct of the business of a legal person as a whole, in respect of a part thereof, or in respect of a specific period*." Accordingly, the scope of management enquiry proceedings is fairly broad. The purpose is to thoroughly investigate a Dutch N.V.'s corporate policy, the conduct of its business, and as of January 1, 2013, also the conduct of its shareholders. The proceedings are used (i) to find out what happened and who bears responsibility for it (through the appointment, by the Enterprise Chamber, of one or more investigators with the instruction to carry out an investigation and to draw up a report), (ii) if necessary and following a finding of mismanagement made by the Enterprise Chamber (based on the investigators' report), to take measures (permanent or not) to restore the relationship among the actors involved in the Dutch N.V. (*i.e.*, shareholders, management, employees), and (iii) to provide for interim relief pending the proceedings and any investigation. Often parties initiate the proceedings solely to obtain interim relief, which can take any shape or form and which in certain instances may be sufficient to obtain a permanent result (*e.g.*, to, effectively, "torpedo" a hostile takeover). The proceedings cannot be used to obtain damages from the Dutch N.V. and/or its directors (or other shareholders), but it can be used as a "fishing expedition" for other types of Dutch or non-Dutch law proceedings in which damages may be available. Often, Enterprise Chamber findings, especially when identifying a clear responsibility for mismanagement, are used in subsequent damage proceedings before the general courts. This court's decisions can be appealed (solely) to the Dutch Supreme Court (*Hoge Raad*), and only on matters of law or insufficient reasoning of the decision of the Enterprise Chamber.

of the company by holding that in these specific circumstances the shareholders could not exercise their right to remove the board since the discussions were still ongoing.

These actions by the court fit in well with the Dutch corporate governance philosophy of promoting cooperation among the various stakeholders and, therefore, to seek (or impose) some form of "compromise." In these circumstances the overarching Dutch corporate law principle of reasonableness and fairness may lead a court to interfere with the shareholders' exercise of their unequivocal statutory right to dismiss the supervisory board. Perhaps the Enterprise Chamber would have ruled differently if the activists had first exhausted all opportunities to come to a compromise (with the boards), before seeking the dismissal of the supervisory board. In any event, the court effectively directed the different stakeholders back to the negotiating table to work out their differences. And, in fact, the parties did reach a settlement under the supervision of the three court-appointed neutral board members.

ASMI

In ASMI (2010), another activist case, shareholders also sought to change the (management) board to implement a new corporate strategy. As in Stork, a *stichting* exercised the call option to fend off the activists, and the activists went to court to initiate management enquiry proceedings. At the Enterprise Chamber the shareholders (initially) found the courts on their side when the Enterprise Chamber ruled that management enquiry proceedings should be opened and focus on the conduct of both the company and the *stichting* (and, therefore, also address the legality of the exercise of the call option under these specific circumstances), but ASMI appealed that decision successfully. The Dutch Supreme Court ruled, among other things, that (i) the formulation of the Dutch N.V.'s corporate strategy and policy is clearly the responsibility of the (management) board, which must take into account the interests of all *stakeholders* (and not only the shareholders), and (ii) the (management) board is under no obligation to discuss or "negotiate" corporate strategy with the Dutch N.V.'s shareholders prior to implementation. The Dutch Supreme Court also held that the actions of the *stichting* (*e.*, to exercise the call option) could not be reviewed in the context of these specific proceedings, meaning that the Enterprise Chamber had no jurisdiction to rule on the legality of the exercise by the *stichting* of the call option under these specific circumstances. This (latter) part of the Dutch Supreme Court's holding has been criticized in the legal commentary, and this part of the ruling might also have been the result of the litigation strategy chosen by the parties, which allowed the Court to view the *stichting's* actions separately from the company's efforts to resist the activists.[8]

Looking at Stork and ASMI together (and also the Dutch Supreme Court's seminal 2007-ruling in ABN AMRO / LaSalle), it is clear that (i) the board has the prerogative to set corporate strategy and policy (and has quite a bit of freedom in doing so), (ii) the board must follow the *stakeholders* model, and (iii) there are limits on the rights of shareholders to control corporate strategy and policy. Shareholders can exercise "negative control" over actions that require formal

[8] The Dutch Supreme Court decision—on this specific jurisdictional point—has been criticized by a number of leading legal commentators. It also deviated from the (earlier) opinion of the Advocate General, an advisor to this court, who agreed with the Enterprise Chamber ruling on this specific point. In future litigation, activists or prospective bidders might present their case in a different way (*e.g.*, presenting the exercise of the call option as a (key) part of the overall "defensive strategy" of the Dutch N.V. to keep the activist or bidder at bay, as opposed to focusing on this specific action of The *stichting*) to avoid the court refusing to review the actions of a *stichting* in the context of the otherwise favorable management enquiry proceedings.

shareholder approval pursuant to statutory law and/or the Dutch N.V.'s Articles of Association, (*e.g.*, a major M&A transaction). Given the prevalence of Poison Pills in Dutch publicly-traded companies,[9] it is currently less clear whether the shareholders in such entities can still exercise their statutory right to dismiss and appoint the board (thus a form of "positive control") for the purpose of changing corporate policy or strategy. Assuming the call option agreement is phrased broadly enough (which was not the case in Stork, but is these days the case when Dutch N.V.s put their Dutch Poison Pill in place), a *stichting* can frustrate an effort by shareholders to replace the board, and in the wake of the Dutch Supreme Court decision in ASMI, activist shareholders cannot rely on the courts to force the board to compromise with them.[10]

KPN

In KPN (2013), a takeover scenario, América Móvil, a Mexican telecom company controlled by Carlos Slim, announced its intention to make an offer for all of the shares in Royal KPN N.V. The KPN *stichting* responded by exercising its call option although at this time América Móvil was still in discussions about its contemplated bid with the KPN boards, the trade unions and the Dutch government. The *stichting* justified this action based on the fact that América Móvil had not yet concluded a customary merger agreement ("merger protocol") with KPN. This was seen by a number of legal and other commentators as a questionable argument given that, as a matter of Dutch takeover law, a prospective bidder is not required to negotiate such an agreement: it can make its bid directly to the target's shareholders. Some viewed the *stichting*'s action as a "pre-emptive strike," likely designed to give further negotiation leverage to the KPN board to obtain more assurances on governance matters and to extract a higher price. Slim opted not to challenge the issuance of the preference shares and ultimately "walked away." The factors influencing this decision could have included: a belief that litigation in tandem with ongoing negotiations would not be a fruitful strategy, a reluctance to acquire a Dutch "Blue Chip" over the objections of incumbent management, and possibly pessimism about the likely outcome of litigation based on the Dutch Supreme Court decision in ASMI. While ASMI involved the use of a Dutch Poison Pill against an activist rather than a hostile bidder, it could be an indication that the Dutch Supreme Court will not uphold a decision of the Enterprise Court to interfere with a *stichting*'s exercise of a call option to block a takeover bid.

Mylan

[9] In 2014, a majority of the large and medium-sized cap Dutch N.V.s that are listed in the Netherlands had issued call options to *stichtings*; that share is probably lower for Dutch N.V.s listed (solely) in the United States. See http://www.eumedion.nl/en/public/knowledgenetwork/publications/2014-evaluation-proxy-season.pdf

[10] In this context, it is relevant to note that under Dutch corporate law and the constituent documents of a large number of Dutch N.V.s it is common for directors to serve four-year terms, as opposed to one-year terms. (Unlike members of U.S.-style staggered boards, directors of a Dutch N.V. can be removed by shareholders at any time for any reason.) In addition, there are a variety of techniques available to the board to "frame" the shareholders' choice. For instance, the constituent documents of a number of Dutch N.V.s provide that the incumbent board can make a so-called "binding nomination" for all vacancies, which result in the nominee being automatically appointed unless the nominee is voted down by a two-third majority of shareholders voting provided that such majority also holds more than half of the issued capital. And in most cases, the general meeting of shareholders will then have the opportunity to fill themselves the slot with a similar majority, while in some cases (see, for example, Mylan N.V.), the board keeps—continuously—the right to make a new binding nomination for the slot (and the general meeting of shareholders keeps the right to continue voting down the nominee with that qualified majority).

In Mylan (2015), another takeover scenario, the call option was “put in place” on April 3, 2015 and, subsequently, exercised on July 23, 2015 by the *stichting* to ward off the then widely-expected unsolicited bid by Teva for all of the shares in Mylan. As in KPN, the *stichting* exercised the call option *before* Teva formally confirmed that it would launch its bid. The *stichting* probably took this action for reasons unrelated to the bid itself, but to ensure that the *stichting* could vote at a scheduled Mylan shareholders meeting to approve the issuance of Mylan shares in an acquisition of Perrigo plc, a transaction that was viewed as a defensive acquisition to drive away Teva. It was anticipated that the *stichting* would not vote all of its Mylan shares in favor of the Perrigo deal, but just enough to offset a possible negative vote by Teva (which held approximately 4.6% of the outstanding ordinary shares). On July 27, only four calendar days following the exercise of the Poison Pill, Teva surprised the market by its announcement that it would acquire Allergan plc’s generics business and no longer pursue its intended bid for Mylan. (The Mylan shareholders subsequently approved the bid for Perrigo, but a majority of the Perrigo shareholders did not tender their shares into Mylan’s bid resulting in Mylan losing its hostile bid for Perrigo.)

Thus, it remains for now untested to what extent, and under what conditions, a *stichting* can exercise a Dutch Poison Pill and hold the preference shares to block a bid that is supported by the holders of a majority of a company’s ordinary shares, but opposed by the incumbent board.