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How to Deal With Unwanted Suitors

A ruling in a Delaware court suggests poison pills are still effective and may continue to be useful as deterrents against hostile bids

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Over the past decade, the number of U.S. companies adopting poison pills has dipped from 2,218 to below 1,000 in 2010, according to data provider FactSet Shark Repellent.

Of the Fortune 500 companies, less than half have a shareholder rights plan written into their bylaws. One might assume poison pills have lost their significance in an era of investor activism. The recent decision upholding the shareholder rights plan of Airgas, however, highlights the fact that poison pills remain as effective as ever.

And while they may not deter bidders from making unwanted offers, the Delaware Court of Chancery ruling will likely embolden target companies to maintain a fighting posture.

Indeed, Family Dollar Stores Inc., CCA Industries and Technology Research Corp., to name a few, have adopted shareholder rights plans in recent months.

In the Airgas case, the company had adopted both a poison pill and a staggered board to ward off suitor Air Products & Chemicals. Following the court's ruling, Robert Schreck, a partner at McDermott Will & Emery, said that for Airgas, the shareholder rights plan "clearly served its purpose."

Whether the decision actually broadened the scope of shareholder rights plans has triggered debate in some circles.

David Grinberg, a partner and chair of Manatt, Phelps & Phillips' mergers and acquisition practice, says the goal of the poison pill traditionally has been to "buy time, and allow boards to disseminate information" to shareholders.

← **Sheppard Mullin** → partner Louis Lehot added that directors have historically been precluded from taking a just-say-no approach to an unwelcome takeover.

Grinberg doesn't feel that the Airgas decision is necessarily a landmark case. He said that had it gone in favor of Air Products, it would have been more of "a barn-burner." Still, the judge having supported a strategy in which shareholders were blocked from deciding for themselves on the merits of the offer was a key takeaway in the ruling.

Vice Chancellor William Chandler, in his opinion, noted that the shareholders were in fact fully informed. But he wrote: "This case does not endorse 'just say never.' What it does is endorse Delaware's long-understood respect for reasonably exercised managerial discretion, so long as boards are found to be acting in good faith and in accordance with their fiduciary duties."

The use of poison pills, predictably, tends to move in lockstep with hostile activity - hence the dropoff in 2008 and 2009. Last year, however, activist investors returned to the market, which resulted in several cases involving poison pills.

Software company Selectica Inc. won a decision against Versata Enterprises that upheld its pill, which protected its net operating loss carry-forwards. That case revolved around the low triggering threshold, which are common to NOL-specific rights plans.

Barnes & Noble also won its case in November supporting its shareholder rights plan against the activist efforts of Yucaipa Cos.

Since the landmark 1985 ruling involving Unocal Corp., poison pills have proven themselves over and over again in court. But companies will likely remain reticent to adopt a rights plan without a direct threat. "These days, if you adopt a rights plan out of nowhere, people are going to wonder what's going on," Grinberg said.

Moreover, the takeover defenses of today are by and large much more shareholder-friendly than what dealmakers may remember from the 1980s, when a poison pill typically had a life span of 10 years. Again, this is a nod to the activists, who have consistently targeted takeover-defense plans in proxy fights.

Beyond poison pills, activists have also stepped up efforts to declassify boards, eliminate supermajority provisions, allow for cumulative voting and eliminate dual-class structures.

While the courts have continually reinforced poison pills, they have also sought some balance as well and alignment with shareholder interests. Schreck, for instance, said he is seeing more rights plans define clearly what a qualified offer should look like.

Periodic independent reviews to determine whether the pill should remain in place also represent a compromise meant to appease activists. Grinberg added that overly prohibitive versions - such as those including dead-hand provisions preventing the poison pill's removal - actually serve to make the rights plan "easier to take down" in court.

Meanwhile, some acquirers have come to embrace poison pills, as evidenced by Dell's request for Compellent Technologies to adopt a rights plan as part of its December acquisition of the storage company. Dell, which had earlier lost a deal for 3Par in a hotly contested auction, pushed for Compellent to enact a poison pill as a form of deal protection.

But the durability of poison pills in the courts will not necessarily deter hostile activity, according to some observers. Grinberg, for one, said, "I don't think hostile acquirers are going to shy away."

Indeed, Carl Icahn's response to Mentor Graphics' implementation of a rights plan was to make public a \$17-per-share bid, putting the onus back on Mentor's board. It's as though the veteran is daring the company to "just say no," in which case dealmakers may get a little more clarity on how Chandler's decision will be interpreted.

---- INDEX REFERENCES ----

COMPANY: COMPELLENT TECHNOLOGIES INC; DELL PRODUCTS (POLAND) SP ZOO; TECHNOLOGY RESEARCH CORP; UNOCAL CORP; DELAWARE INVESTMENT ADVISORS INC; DELL COMPUTER SPOL

SRO; DELL SAS; YUCAIPA COS; MENTOR CORP; EGYPTIAN COMPANY FOR INTERNET AND DIGITAL INFRASTRUCTURE; DELL GMBH; DELL FZ LLC BAHRAIN BRANCH; DELAWARE DISTRIBUTORS LP; YUCAIPA COMPANIES LLC; DELAWARE ENHANCED GLOBAL DIVIDEND AND INCOME FUND; DELL PROFESSIONAL SERVICES INC; DELL AS; DELL INC; DELL S R O; OY DELL AB; BARNES AND NOBLE INC; SELECTICA INC; AIR PRODUCTS AND CHEMICALS INC; DELL SP ZOO; UNOPASO; DELL AB; FAMILY DOLLAR STORES INC

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