

CORPORATE AND SECURITIES LAW

Alert

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Poison Pill Re-Emerges As Takeover Defense

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The poison pill, an anti-takeover device originally developed in the early 1980s, has seen a resurgence over the last year, as depressed stock market prices have made many public companies—especially those with small total market capitalizations—vulnerable to unsolicited offers or hostile takeover attempts. Now is a good time for public companies with existing rights plans to review the terms of their plans and for public companies that do not have a rights plan to evaluate the relative merits of and steps necessary for implementing a plan. Moreover, unlike other defensive measures such as classified boards, shareholder rights plans can typically be adopted or amended by board action without shareholder approval.

A poison pill, which is embodied in a shareholder rights plan adopted by a public company, is designed to deter coercive or abusive actions by significant shareholders of a company and to centralize power in the board of directors in the event of a hostile takeover or unsolicited offer. Under a shareholder rights plan, rights are granted to shareholders upon the plan's adoption to buy additional shares of the company at a significant discount to market (the "flip-in" feature) in the event that an acquiring shareholder crosses a specific ownership threshold, typically 15% or 20% (the acquiring shareholder is not permitted to exercise these rights). Because of the massive dilution that would occur if a plan were triggered, until recently, no modern form of rights plan had ever been intentionally triggered in the United States. (In December 2008, a shareholder of Selectica, Inc., a public company, deliberately triggered the company's pill, a matter which is the subject of ongoing litigation in Delaware).

In recent years, the use of poison pills had declined, largely in response to criticism and pressure from activist investors and proxy advisory services such as RiskMetrics Group (formerly ISS). However, recent stock market declines have increased the willingness of many companies to revisit the use of this device. In 2008, 76 public companies adopted shareholder rights plans for the first time, the first year since 2005 in which there has been a year-over-year increase in the first-time adoption of plans. A significant percentage of these plans (22% of first-time adoptions) were "in play" adoptions adopted in response to a specific threat.

The sharp decline in market capitalizations has also lessened the advance warning protections afforded by antitrust laws for many companies. Under federal securities laws, a shareholder with activist intentions is required to make a public filing on Schedule 13D within ten days of acquiring a 5% ownership position in a company. While this disclosure requirement provides some advance notice, an acquiring shareholder may be able to acquire an ownership stake far in excess of 5% during the 10-day period before which a

shareholder must make a filing. An additional layer of advance warning is provided under the Hart-Scott-Rodino Antitrust Improvements Act, which generally requires a shareholder to observe a 30-day waiting period before consummating an open-market acquisition of voting securities of a company with a value of at least \$65.2 million that constitute at least 10% of the outstanding voting securities of the company (during which time the acquisition may be subject to antitrust review). However, companies with a market capitalization of less than \$650 million could have a potential acquirer rapidly accumulate a stake of 10% or greater without triggering this early warning notification requirement (due to the fact that no filing will be required until \$65.2 million of securities are acquired), a scenario made more likely by recent stock market declines.

Thus, public companies, particularly those with smaller market capitalizations, are once again turning to poison pills. Other companies, while allowing their existing rights plans to expire or not adopting a new plan, are putting a rights plan “on the shelf” that can be quickly adopted in response to a future emerging threat.

Even as shareholder rights plans regain prominence, the terms of new plans continue to be impacted by pressures from shareholder activists, particularly RiskMetrics Group. For instance, 46% of first-time plans adopted in 2008 had a term of three years or less, while at the start of the decade terms of less than ten years were extremely rare. Shareholder activists have had less success in influencing other features of plans (for example, the vast majority of newly-adopted plans are not submitted to shareholders for their approval, despite strong opposition from RiskMetrics to this prevailing practice). Nevertheless, the views of a company’s shareholder base and proxy advisory services such as RiskMetrics need to be closely considered when a company evaluates the merits of adopting a plan or the features to include in a plan. We expect that the influence of activist shareholders and proxy advisory services will continue to have a significant impact on practice in this area.

If your company is in the process of adopting a poison pill or amending an existing one, these new developments should be considered. If you have any questions regarding this Corporate & Securities Law Alert, please feel free to contact any of your regular contacts in the Corporate & Securities Group or any of the following attorneys in our Shareholder Activism subgroup.

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