

# *Innovations in Poison Pill Drafting*

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## Recent legal and market developments have led to changes in the way poison pills are being designed.

**R**ights plans, commonly known as poison pills, have been employed for almost three decades. As a legal matter, the validity of poison pills is clear. In the market, however, poison pills are facing new challenges.

The influential advisory firm Institutional Shareholder Services Inc. (ISS) and stockholder activists generally oppose pills and boards that adopt them. Many companies are allowing their pills to expire, leaving them “on the shelf” (shelf pill) for adoption only if an active threat arises. Meanwhile, hostile acquirors are taking advantage of market developments to increase their leverage, such as acquiring derivative instruments that track a target company’s stock. These market developments have led to changes in the way poison pills are being drafted.

This article reviews recent legal and market developments influencing poison pills, and explores drafting innovations resulting from these developments.

>> For a Practice Note explaining how poison pills work, different state law approaches, and board and stockholder considerations, search [Poison Pills: Defending Against Takeovers and Protecting NOLs](#) on our website.

### RECENT LEGAL DEVELOPMENTS

The validity of poison pills and the authority of a board of directors to adopt and maintain a poison pill to prevent a hostile acquisition are well established. In fact, in a 2009 case, the Delaware Court of Chancery found that a board of directors could be liable for not adopting a poison pill (see *La. Mun. Police Emp. Ret. Sys. v. Fertitta*, 2009 Del. Ch.

*LEXIS 144 (Del. Ch. July 28, 2009)*). This is consistent with the general trend of Delaware case law, which favors poison pills. For example:

- In *Air Products & Chems, Inc. v. Airgas, Inc.*, the Delaware Court of Chancery allowed a pill to remain in place even though a control contest had been ongoing for over a year. The stockholders were fully informed and the only threat to stockholders was that the hostile acquiror's tender offer was viewed by the target's board as inadequate (*16 A.3d 48 (Del. Ch. 2011)*).
- In *Yucaipa Am. Alliance Fund II, L.P. v. Riggio*, the Delaware Court of Chancery upheld the adoption of a poison pill to prevent an opponent of the board from acquiring over 20% of the target's stock, even though the board's chairman owned 30% of the target (*1 A.3d 310 (Del. Ch. 2010)*) (referred to in this article as *Barnes & Noble*)).
- In *Selectica, Inc. v. Versata Enters., Inc.*, the Delaware Supreme Court upheld a poison pill with a 4.99% trigger (as opposed to the typical trigger of 15%). The court found that the low trigger was intended to protect the target's substantial NOL tax credits, which could be lost on a relatively modest ownership change under federal tax law (*2010 Del. Ch. LEXIS 39 (Del. Ch. Feb. 26, 2010)*).

>> For more information on the *Selectica* case, search [In Dispute: Selectica](#) on our website.

- In *In re CNX Gas Corp. S'holders Litig.*, the Delaware Court of Chancery stated that if an independent committee were formed to consider a transaction with the company's controlling stockholder, that committee should be given the authority to adopt a poison pill to prevent the controlling stockholder from increasing its stake or otherwise circumventing the committee (*4 A.3d 397 (Del. Ch. 2010)*).
- In *In re Orchid Cellmark Inc. S'holder Litig.*, the Delaware Court of Chancery upheld a merger agreement provision in which the target agreed (absent terminating the merger agreement for a superior proposal and paying a termination fee) not to amend, waive or redeem its pill or take any other action that would allow anyone other than the acquiror to obtain 20% of the target's stock without triggering the pill (*2011 Del. Ch. LEXIS 75 (Del. Ch. May 12, 2011)*).

Of course, these cases do not mean that Delaware courts will always uphold poison pills. In *Airgas*, then-Chancellor Chandler stated misgivings about the continued use of the poison pill in that case, but felt constrained by precedent. In *eBay Domestic Holdings, Inc. v. Newmark*, Chancellor Chandler ordered rescission of a poison pill that was adopted by two individuals who were the majority stockholders, directors and officers of a private company owned by three stockholders (*16 A.3d 1 (Del. Ch. 2010)*), finding that the likely purpose of the pill was to prevent the minority holder

from being able to purchase shares if a majority holder died or had to sell shares.

## MARKET PRESSURES

While Delaware law is favorable to poison pills, the market is more skeptical. ISS generally opposes the election of directors who adopt or extend a poison pill with a duration of more than one year without stockholder approval. Even if the pill has a term of less than one year, ISS may, depending on the facts and circumstances, oppose the election of the board unless the pill is expressly subject to stockholder approval.

If the pill is put to a stockholder vote, generally it must have certain features to get ISS's support, including:

- A trigger of at least 20%.
- A duration of no more than three years.
- No limitation on the ability of a future board to redeem the pill (a "dead-hand" or similar provision).
- A stockholder redemption feature if the company receives a qualifying offer for the company.
- The ability by the holders of 10% of the outstanding shares to call a special meeting or seek a written consent to vote on rescinding the pill if the board fails to redeem the pill 90 days after a qualifying offer.

ISS also weighs the company's existing governance structure and requires the board to explain its rationale for adopting a poison pill. Like ISS, stockholder activists generally oppose pills. In addition, with majority voting in place now at many companies, stockholders can replace directors who keep pills without even holding a proxy contest.

>> For an example of a majority voting provision, search [By-laws or Certificate of Incorporation: Majority Voting Provision](#) on our website.

Because of the market opposition to poison pills, boards have become more reluctant to adopt them. However, while many companies no longer have a pill in place, they do have a pill on the shelf, which can be readily adopted if an actual takeover threat materialized. Because a shelf pill would only be deployed in response to a specific and present threat, the pill can be tailored to that threat.

## DRAFTING CHANGES

The legal and market developments discussed above have led to innovations in the way poison pills are being drafted. In particular, modern poison pills are often designed to address several issues, including:

- The use of derivative instruments by would-be acquirors.
- Stockholders who may be "acting in concert."
- The availability of a window (rather than an immediate trigger) to redeem or amend a pill after someone becomes a triggering stockholder under the pill.
- Grandfathering stockholders into a pill.

- The duration of the pill.
- More flexible exchange features.

## DERIVATIVE INSTRUMENTS

Historically, most poison pills were drafted to be triggered if a party acquired beneficial ownership of 15% or more of the company's common stock. However, derivative instruments give stockholders and future acquirors a creative way to gain a position of ownership and influence in a company, without necessarily acquiring the requisite beneficial ownership that would trigger a traditional pill (see *Box, Derivative Instruments: An Example*). For example, in October 2010, Pershing Square used derivative instruments, in part, to amass over a 16.5% stake in J.C. Penney.

From a company's perspective, a holder of a derivative instrument would not be a concern if that ownership constituted "beneficial ownership" under the triggering provision of the company's poison pill. However, it is not clear that derivative instruments fall within the classic definition of beneficial ownership under a typical poison pill. This definition usually provides that a person beneficially owns any securities that:

- The person owns directly or indirectly.
- The person has the right to acquire or vote.
- Are owned by another person, with whom the person has an agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of the securities.

It is also unclear whether stockholders must disclose the ownership of derivative instruments under federal securities law reporting requirements (see *CSX Corp. v. The Children's Inv. Fund Mgmt. (UK) LLP, 2011 U.S. App. LEXIS 14653 (2d Cir. July 18, 2011)*).

In response to this threat by holders of derivative instruments, many companies are now amending or drafting their poison pills to explicitly include derivative instruments in the types of securities a stockholder is deemed to beneficially own for purposes of triggering the pill.

However, the Delaware courts have not addressed directly the inclusion of derivative instruments in pill triggers. In 2008, would-be acquirors of Atmel challenged the decision by Atmel's board to amend the company's poison pill to include derivatives instruments in the pill's definition of beneficial ownership. The plaintiffs argued that the amendments were a breach of the board's duties to manage the company because the derivatives language in the pill was so vague. But, the litigation never resulted in a formal decision. The case concluded only with a transcript decision in which the Delaware Court of Chancery refused to preliminarily enjoin the pill on those grounds, and the parties later settled (*In re Atmel Corp. S'holders Litig., C.A. No. 4161-CC (Del. Ch. May 19, 2009) (transcript)*). Derivatives language was also included in

## Derivative Instruments: An Example

To understand the problems derivative instruments pose in the takeover context, consider the following example:

- A bank enters into a derivative contract with an investor, who may have an established relationship with the bank, relating to some notional number of shares of a company's stock.
- The derivative contract grants the investor the economic benefits and costs that would come with owning the shares. The investor, in turn, pays the bank a fee or interest for the arrangement in addition to compensating the bank for any decrease in the market value of the referenced securities.
- The bank owns actual shares of the company's stock as a hedge (even though the bank is not required to do so by the terms of the derivative contract).

As a practical matter, the investor may be able to use its relationship and ongoing economic arrangement with the bank to influence how the bank votes the shares that are owned by the bank. In addition, the investor may be able to swiftly acquire actual ownership of the shares from the bank. These scenarios illustrate how the holder of a derivative instrument may be able to gain influence and control over a company's stock.

the poison pill that the Delaware Court of Chancery recently upheld in *Barnes & Noble*, but that language was not directly at issue in the case.

Addressing derivative instruments in poison pills raises at least three key issues:

- How to define a derivative instrument.
- How to determine what shares the holder of a derivative instrument is deemed to own.
- Whether and how the rights attached to shares associated with derivative instruments should be voided.

Although these issues can be dealt with in a variety of ways, there are identifiable approaches that companies can take. A board considering the adoption of derivatives language should discuss with the company's advisors the best approach for addressing derivative instruments, in light of the company's circumstances and stockholder base. In the case of a shelf pill, the board should obtain this information at the time it actually considers deploying the pill to address any legal or market developments (both generally and in the specific circumstances faced by the particular company).

### Defining Derivatives

In defining derivative instruments in poison pills, some companies explicitly link their definition to Rule 16 under the Securities Exchange Act of 1934 (Exchange Act), which regulates short-swing profits and includes a definition of



derivative securities. For example, Mentor Graphics' poison pill deems a person to beneficially own:

the full notional amount of any securities that, directly or indirectly, underlie any "derivative security" (as such term is defined in Rule 16a-1(c) under the Exchange Act) that constitutes a "call equivalent position" (as such term is defined in Rule 16a-1(b) under the Exchange Act) ... and that is, directly or indirectly, held or maintained by such Person.

(See *Mentor Graphics Corp., Rights Agreement (June 25, 2010)*.)

Some companies define a derivative instrument as an instrument whose value is based on the value or price of the company's securities. For example, Talbots' poison pill provides that a derivative transaction is:

any direct or indirect ... transaction or series of transactions in, or agreement, arrangement, understanding or relationship with respect to, any option, warrant, convertible or exchangeable security, stock appreciation right or right similar to any of the foregoing with an exercise, conversion or exchange privilege, or settlement payment or mechanism, related to any security of the Company, or similar instrument with a value derived in whole or in part from the value of any security of the Company [or any] transaction or series of transactions, arrangement, agreement, proxy, understanding or relationship which included or includes an opportunity for such Person or such Person's Affiliates or Associates, directly or indirectly, to profit or share in any profit derived from any increase or decrease in the value of any security of the Company.

(See *The Talbots, Inc., Rights Agreement (Aug. 2, 2011)*.)

Other companies rely on an "ownership equivalence" concept and include derivative instruments if they are designed to replicate the economics of owning shares of the company's stock. For example, Eastman Kodak's poison pill defines a derivative instrument as a contract that:

is designed to produce economic benefits and risks ... that correspond substantially to the ownership ... of a number of Common Shares specified or referenced in such contract.

(See *Eastman Kodak Company, Rights Agreement (Aug. 1, 2011)*.)

Companies may also combine these approaches in defining beneficial ownership.

### **Deemed Ownership of Shares**

Another issue companies should consider is which approach to use to determine the number of shares that a person is deemed to own under a derivative instrument. A derivative instrument only corresponds to a company's securities and

is not actually issued by the company. Therefore, the poison pill must specify what shares an acquiring person should be deemed to own. Ownership can be based on:

- The shares of common stock that are “subject to,” “underlie” or serve as the “reference securities” for a derivative instrument (for example, see *Barnes & Noble, Inc., Rights Agreement (Nov. 17, 2009)*).
- The shares “beneficially owned” by the person (the counterparty (for example, a bank)) with whom the owner of the derivative instrument enters into the derivative contract (for example, see *Atmel Corporation, Amendment to Amended and Restated Preferred Shares Rights Agreement Amendment (Nov. 10, 2008)* and *Cracker Barrel Old Country Store, Inc., Rights Agreement (Sept. 22, 2011)*).

Under the first approach, the full notional number of shares subject to the derivative instrument is deemed owned by the derivative holder, whether or not any counterparty to the derivative contract actually holds or has the right to acquire the shares.

The second approach looks to shares actually held by the counterparty so that the pill includes only shares that can actually be influenced or purchased by a potential acquiring person. Poison pills taking this approach may also look to successive derivative contracts into which the original counterparty enters, and may deem an acquiring person to beneficially own shares held by successive counterparties. The purpose of this additional step is to trace the chain of derivative contracts to reach the shares of the target company that ultimately are the center of influence and ownership.

In addition, some companies, such as Mentor Graphics, only include derivative instruments within a person’s beneficial ownership if the person is otherwise a traditional beneficial owner of 5% or more of the company’s securities. As a general matter, poison pills with derivatives language usually deem the owner of the derivative instrument to beneficially own no more than the notional number of common shares specified in the document evidencing the derivative instrument. Some poison pills alternatively provide that if the derivative instrument does not include a notional number, the company’s board of directors can determine the number (for example, see *J.C. Penney Co., Inc., Stockholder Protection Rights Agreement (Oct. 18, 2010)*).

### Voiding of Rights

Under a typical poison pill, if a person becomes an acquiring person and triggers the pill, the rights beneficially owned by that person are deemed voided. As a result, the acquiring person, unlike other stockholders, cannot exercise rights to purchase discounted stock.

If a pill can be triggered due to ownership of derivatives, that is because a person’s ownership of derivatives is deemed to be ownership of the shares to which those derivatives relate. The

question, then, is whether all the rights attached to the shares should be voided, even if the acquiring person, who holds the derivatives, does not actually hold the related shares (which may be held by a bank or some other counterparty).

If an acquiring person who is a party to a derivative contract is deemed to own either the full notional number of shares underlying the derivative instrument or the shares actually held by the counterparty or successive counterparties, then the rights attached to shares held by someone other than the acquiring person would appear to be voided under the standard terms for voiding used in most pills. This means that some other person actually holding the shares could be diluted.

Some commentators suggest that an acquiring person should be deemed to beneficially own shares related to a derivative instrument only for the purpose of counting whether a person has crossed the ownership threshold, and not with the intent of voiding and diluting some other stockholder’s rights and shares. This question remains untested in court. However, if a company does not want a triggering of its pill to result in the voiding of all shares tied to a derivative instrument, regardless of who actually holds those shares, then it should make sure this is clearly drafted into the pill.

Finally, an important point to keep in mind concerning derivative instruments and shelf pills is that even if the shelf pill contains a derivatives provision, that provision will have no impact on stealth acquisitions, unless the pill is actually taken off the shelf and adopted.


### STOCKHOLDERS ACTING IN CONCERT

Traditionally, poison pills were drafted to prevent a certain level of activity between stockholders. To accomplish this, the definition of beneficial ownership usually includes shares subject to “an agreement, arrangement or understanding for the purpose of holding, voting, acquiring or disposing of stock.” The Delaware courts have generally upheld this approach, concluding that it will not fundamentally restrict the right of stockholders to wage proxy contests (for example, see *Stahl v. Apple Bancorp, Inc., 1990 Del. Ch. LEXIS 121 (Del. Ch. Aug. 9, 1990)*). In recent years, the question has emerged as to whether poison pills should go a step further than the traditional approach and regulate stockholders “acting in concert.”

The purpose of an acting in concert provision is to prevent stockholders (particularly hedge funds) from cooperating with or acting parallel to each other in ways that fall short of an “agreement, arrangement or understanding,” but still effectively allow the stockholders to act in a large block (known as the wolf pack or conscious parallelism problem).

For example, in the Genesco poison pill, acting in concert is defined as follows:

A Person shall be deemed to be “Acting in Concert” with another Person if such Person knowingly acts



(whether or not pursuant to an express agreement, arrangement or understanding) in concert with such other Person in, or towards a common goal relating to, changing or influencing the control of the Company or in connection with or as a participant in any transaction having that purpose or effect, in parallel with such other Person where at least one additional factor supports a determination by the Board of Directors that such Person intended to act in concert or in parallel with the other Person, which such additional factors may include, without limitation, exchanging information, attending meetings, conducting discussions, or making or soliciting invitations to act in concert or in parallel. A Person who or which is Acting in Concert with another Person shall also be deemed to be Acting in Concert with any third party who is also Acting in Concert with such other Person.

(See *Genesco Inc., Second Amended and Restated Rights Agreement (Apr. 9, 2010)*.)

In a milder version of this provision, Barnes & Noble's poison pill deemed a stockholder to beneficially own the shares of any other person with whom the stockholder has "any agreement, arrangement or understanding (written or oral) to cooperate in obtaining, changing or influencing the control of the Company."

Barnes & Noble adopted its pill after the emergence of a potential insurgent stockholder. The pill originally contained the acting in concert language quoted above. The insurgent stockholder filed an action challenging the pill generally, and also sent a letter to the board specifically challenging the acting in concert language. During the litigation, Barnes & Noble amended its pill to eliminate this language. In ultimately upholding Barnes & Noble's poison pill in a post-trial opinion, the Delaware Court of Chancery took comfort in the return

In deciding whether to include acting in concert language, companies and their advisors should carefully consider the nature of the threat actually faced by the company (for example, the identity of the hostile party and its apparent strategy). The traditional definition may offer adequate protection and going beyond that definition could introduce legal uncertainty.

#### POST-TRIGGER WINDOW FOR REDEMPTION OR AMENDMENT

Once adopted, a poison pill typically can be terminated by the board before its expiration date either by:

- Amending the pill (for example, to accelerate its expiration date).
- Redeeming the outstanding rights (typically for nominal consideration, as set out in the rights plan).

Most poison pills provide that the pill cannot be terminated once it is triggered. This means that the board cannot call off a triggering of the pill, except in the circumstance of an inadvertent triggering where the buyer promptly sells down below the trigger percentage. However, it is not unusual for pills to give a board a certain limited period of time (such as a ten-day window) to defuse the pill by amendment or redemption, even after an acquiring person has crossed the trigger threshold (for example, see *Airgas, Inc., Rights Agreement (May 8, 2007)*).

Drafting a poison pill to include an irreversible trigger provides maximum deterrence against hostile acquirors. If the pill instead has a window allowing the board to call off a triggering, an aggressive acquiror could be tempted to gamble that the board will ultimately not allow the pill to be triggered.

Similar issues must be considered if the board decides to adopt an "exempt person" approach, through which a board can exempt a particular person from triggering the pill (for example, see *McCormick & Schmick's Seafood Restaurants, Inc., Rights Agreement (Apr. 21, 2011)*). In this case, the definition

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to standard language as a result of the amendment, noting that "as amended, the definition of beneficial ownership ... is no different than the language that has been incorporated into countless rights plans since *Moran*" (the 1985 Delaware Supreme Court decision upholding the use of a pill).

of acquiring person carves out any person that the board, acting some time after the adoption of the pill, deems to be an exempt person. For the greatest deterrent effect, however, the board's ability to grant this exemption should end if the pill is triggered (at least as to the triggering person).

## GRANDFATHERING STOCKHOLDERS

If a company has any stockholders who would already be at or above the poison pill's triggering ownership percentage when the pill is adopted, the company must "grandfather" those stockholders to avoid an immediate triggering of the pill. To do so, the poison pill would exclude any stockholder who owns a specified percentage of the company's securities from the definition of acquiring person at the time the pill is either adopted or publicly announced. This type of provision would also typically place a cap on that stockholder's ability to increase its ownership percentage. However, pills often give the grandfathered stockholder some leeway, such as the ability to acquire another 1% of the company's stock.

If the grandfathered stockholder has a complicated ownership structure, counsel must consider whether and how to include a grandfathered stockholder's related entities within the exemption. For example, a basic grandfather provision in a pill might provide that "Acquiring Person" will not include "any Person who is the Beneficial Owner of 15% or more" of the company's stock at the time the pill is adopted. Because "Beneficial Owner" is usually drafted to refer to a person and its affiliates and associates, the affiliates and associates of the grandfathered stockholder who exist when the pill is adopted will be exempted from the pill.

However, this approach does not address two potential issues:

- It only includes affiliates and associates who exist at a particular snapshot in time, and a new affiliate or associate could technically trigger the pill. To solve this problem, a company could include language in its pill that allows these new affiliates or associates of a grandfathered stockholder to be attributed grandfathered ownership status. However, companies may also wish to provide that in the case of a new affiliate who acquires control of a grandfathered stockholder, grandfathered status will only be extended to that new affiliate if that affiliate is approved by the company's board (for example, see *Monolithic System Technology, Inc., Rights Agreement (Mar. 26, 2003)*).
- Certain affiliates of the grandfathered stockholder could become associates of persons or entities that were not initially grandfathered (for example, if the affiliate were an individual who remarried or a company that hired a new officer). In these cases, the new party could be attributed the ownership of the affiliate, but, depending on how the pill was drafted, would not necessarily benefit from the grandfather provision. Given that most pills provide the board with broad power to interpret and administer the pill, an unintentional triggering on such technical grounds is probably unlikely. Nonetheless, drafters may wish to consider this issue on a case-by-case basis.

### PRACTICE NOTES

DOCUMENTS

CLAUSES

CHECKLISTS

ARTICLES

The following related Practice Notes can be found on [practicallaw.com](http://practicallaw.com)

>> Simply search the title OR resource number

[Poison Pills: Defending Against Takeovers and Protecting NOLs or 3-386-0340](#)

[Defending Against Hostile Takeovers or 9-386-7206](#)

[Fiduciary Duties of the Board of Directors or 6-382-1267](#)

If a poison pill is only being adopted in response to a specific threat (off the shelf or otherwise), the company may have a clearer idea at that time whether it is advisable to address these future ownership issues.

### DURATION OF THE PILL

Traditionally, poison pills were drafted with a duration of ten years. Increasingly, however, companies have adopted pills with a shorter lifespan. In some cases the pill is put to a stockholder vote one year from its adoption or automatically expires after one to three years. For example, Barnes & Noble's poison pill had an automatic expiration date of three years. Further, the company held a stockholder vote on the pill after one year.

ISS's guidelines state that:

- Pills put to a stockholder vote an adoption should have a duration of three years.
- Pills not put to a stockholder vote on adoption should be put to a stockholder vote within one year.

The increased use of shelf pills may affect the duration of a pill. If a pill is pulled off the shelf in response to a specific threat, the primary purpose of the pill could be to prevent any party from gaining too large a position before the next election of the board, at which time stockholders can effectively decide whether to endorse the hostile offer or the pill. In this circumstance, a pill with a one-year term might suffice. If the incumbent board is re-elected and it believes the threat continues, the board can renew or readopt the pill at that point, weighing the downside of any opposition from ISS or stockholders.

However, if a pill is adopted in response to a specific threat, the board may be less concerned about opposition and more interested in having a poison pill with maximum potency and duration. For example, in the Airgas takeover battle, the target company had a ten-year poison pill.

### SELECTICA EXCHANGE ISSUE

In early 2009, Selectica's poison pill was intentionally triggered. It then had to work through how to implement the exchange

feature of its pill. Intentional triggering of pills is extremely rare. Before the triggering of Selectica's pill, the last known intentional triggering of a pill occurred in the 1980s, in the attempted takeover of Crown-Zellerbach. Therefore, Selectica had very little practical guidance concerning the back-office mechanics involved in administering a pill post-trigger and in completing an exchange. In particular, Selectica had difficulty:

- Determining the identity of its stockholders.
- Ensuring that exchange shares were not transferred to an acquiring person.

The exchange took approximately one month and resulted in a freeze in the trading of Selectica's stock during that time.

In response to the lessons learned from Selectica, companies now frequently consider amending their existing pills or drafting new pills that include provisions to give them additional time and flexibility in case they need to use the exchange feature following a triggering. These provisions may include:

- Giving the company additional time to distribute rights certificates, if the board decides to use the exchange feature.
- Allowing the company to use an independently managed trust into which the company deposits shares to be received in an exchange until the company can determine who is, and who is not, an acquiring person and its affiliates.
- Allowing the trustees of the trust to exercise the rights of stockholders.

## REMEDIES FOR AN OFFENDING PROVISION

Although poison pills have been routinely upheld by the Delaware courts, the majority of the drafting issues discussed in this article are relatively untested. If a court determines that a provision goes too far, it is uncertain whether the court will simply strike the offending provision (known as blue penciling) or invalidate the pill as a whole. Delaware courts have expressed some reluctance toward blue penciling excessive deal protection, such as termination fees in the merger context (for example, see *In re Netsmart Technologies, Inc. S'holder Litig.*, 924 A.2d 171, 209 (2007)).

However, there are several arguments in favor of blue penciling a pill, including the following:

- Pills often contain severability clauses.
- Pills generally are not bilaterally negotiated contracts like merger agreements, where blue penciling could undo one party's bargained-for expectations.
- Some poison pill cases suggest that courts may prefer to strike offending provisions, rather than the entire pill. For example, in *Quickturn Design Sys., Inc. v. Shapiro*, the famous

case involving a "dead-hand" poison pill, the court struck the dead-hand provision itself, not the entire pill (721 A.2d 1281 (Del. 1998)).

- Parties' arguments often focus on whether a provision should be modified or struck, not whether the pill, as a whole, should be rescinded (see *Barnes & Noble*).
- Chancellor (then-Vice Chancellor) Leo Strine of the Delaware Court of Chancery has noted that blue penciling may be less intrusive than wholesale invalidation (see *Leo E. Strine, Jr., Categorical Confusion: Deal Protection Measures In Stock-for-Stock Merger Agreements*, 56 *Bus. Law.* 919, 941 n.71 (2001)).

However, a recent case suggests another approach. In *Barnes & Noble*, the board adopted an aggressive provision initially, but used its ability to amend the pill to delete the challenged provision when litigation ensued (see above *Stockholders Acting in Concert*).

Because the days of "one size fits all" poison pills appear to be over, it is essential for a board considering adopting a pill (including adopting a pill that was previously on the shelf) to receive input from its advisors concerning the current state of the market and the law with respect to the key features of the pill.

*Morris, Nichols, Arsht & Tunnell LLP has been counsel in several of the cases discussed in this article. The views in this article are those of the authors, and not necessarily those of the firm or its clients.*