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REVIEW OF ANTI-TAKEOVER DEFENSES: THE SHAREHOLDER RIGHTS PLAN

The last several months have ushered in a period of economic instability not seen in decades, accompanied by increased regulatory focus on shareholder activism. Publicly-traded companies have been particularly hard-hit, with the stock price of many companies falling well below historic norms. There is considerable risk for undervalued companies, in particular, once the overall economy begins to recover. Many of these companies have not focused on implementing or maintaining their strategic defenses against unwanted takeover attempts. As such, they may increasingly become targets for unsolicited and hostile takeover attempts as strategic buyers and private equity funds begin to deploy capital into acquisition activities.

Anti-Takeover Defenses

In the current market environment, companies should revisit their anti-takeover defenses in order to protect the company and its stockholders from offers that do not maximize stockholder value. There are a number of defensive takeover mechanisms, including the issuance of blank check preferred stock, a classified board of directors, limitations on stockholder action by written consent, or on stockholders calling a special meeting, to name a few. By far, the most well known and the easiest to implement on an expedited basis is the shareholder rights plan, commonly known as a "poison pill."

The Shareholder Rights Plan

The purpose of a shareholder rights plan is to force an acquirer to negotiate with the target company's board of directors. Typically, if any person or group acquires a certain percentage (usually between 10-25 percent) of the voting power of the company's outstanding common stock, stockholders of the company (other than the acquiring person) have the right to buy common stock at a substantial discount (often at 50 percent of the market price). This results in substantial dilution of the acquiring person's investment in the company and would likely thwart the takeover bid. The target company's board of directors can vote to amend or terminate the shareholder rights plan. This gives the target company's board substantial leverage in negotiating on behalf of its stockholders for a purchase price more in line with the true value of the company.

Trend: Adoption of Shareholder Rights Plans on the Rise

Since its inception, the shareholder rights plan has been a subject of debate and has faced increased scrutiny over the past five years. Institutional shareholders and corporate governance rating companies have criticized shareholder rights plans as a means to entrench management. Generally, shareholder activist groups have recommended that shareholders withhold support for such plans. These shareholder activist groups have gradually softened their position against shareholder rights plans. This more accepting attitude may be attributed to an increased focus on protecting stockholder value in this challenging economic environment. Shareholder activist groups now accept shareholder rights plans but have advocated that such plans contain at least a 20 percent trigger, sunset provisions that are relatively shorter term, and no "dead hand" provisions, which allow only continuing directors to redeem pills and generally have a chilling effect on proxy contests. These groups also support features such as the "chewable pill," a provision that requires a company receiving a qualified offer from a third party to present the opportunity to its stockholders for approval.

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In the current market climate, the adoption of shareholder rights plans is on the rise. In 2008, 127 public companies adopted poison pills, the most since 2002. This rising trend cuts across all company sizes and industries. The trend has continued in 2009, with many attributing the increased use of shareholder rights plans to the steep decline in market value of equity securities and the increasing concerns about unsolicited and coercive takeovers. Despite the institutional shareholders' preference for certain features, such as a chewable pill or sunset provisions, many companies are implementing shareholder rights plans without such provisions.

Implementing or Amending a Shareholder Rights Plan

If a company chooses to adopt a shareholder rights plan, there are several steps that must be followed to ensure the shareholder rights plan will work as intended, such as the authorization of sufficient common and preferred shares and appropriate filings with the SEC and the company's state of incorporation. If a company has an existing shareholder rights plan, it should re-examine the procedural and substantive steps used to implement the plan to make sure it will function as intended. For example, if a shareholder rights plan was put into place several years ago, the company should revisit the exercise price set forth in the plan.

Companies Should Review Their Existing Takeover Defense Strategy

Given the current state of the market, companies should revisit the defensive takeover mechanisms they have in place. In particular, public companies that believe their stock is undervalued and do not have sufficient takeover defenses in place should consider whether it makes sense for their company to adopt a shareholder rights plan. Companies that currently have an older shareholder rights plan in place should revisit whether it continues to meet the needs of the company. It is important for companies to note that shareholder rights plans are not "one size fits all" and each company should evaluate which features make sense for it and recognize that their priorities and needs may change over time. Whether implementing a new plan, or evaluating an existing plan, it is important to work with legal counsel to determine what mechanics and features fit the company's needs and shareholder base.

Please contact any of the attorneys listed on this Alert if you would like to discuss your current anti-takeover defenses and strategy.

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