THOMPSON HINE

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PUBLIC COMPANY UPDATE

# Placing a Poison Pill "On the Shelf"

## OVERVIEW

Due to pressure from activist hedge funds, RiskMetrics (formerly ISS) and others beginning around 2002, companies have been terminating their poison pills or allowing them to expire at the end of their terms without renewing them. As a result, although as many as two-thirds of U.S. public companies had poison pills in the early 2000s, less than one-fourth had poison pills at the end of 2008. In light of the current depressed market conditions and increased shareholder activism, however, the poison pill remains an important protective measure for public companies, particularly small and mid-cap companies. Although many companies currently face an increased risk from potential acquirers and activist shareholders, they also face potential adverse voting recommendations from RiskMetrics and others if they take action to adopt a conventional poison pill. Companies in these circumstances should consider preparing a poison pill and placing it "on the shelf" for adoption when needed to confront a takeover threat or activist shareholder.

## RISKMETRICS VOTING GUIDELINES

### *Shareholder Approval*

RiskMetrics will generally recommend voting withhold/against an entire board of directors if the board adopts or renews a poison pill without obtaining shareholder approval or making a commitment to put the poison pill to a shareholder vote within 12 months of adoption. As an example, The Cooper Companies, Inc., Rogers Corporation and Plexus Corp. are among the companies that had one or more directors receive a majority withhold vote within the past two years partially because their poison pills were not subject to a shareholder vote. Directors of companies that have adopted majority voting for the election of directors are, of course, at greater risk when receiving a withhold/against recommendation from RiskMetrics.

### *Required Provisions*

If a board puts a poison pill to a vote of its shareholders, RiskMetrics will review the board's reasons for adopting the poison pill, the company's existing takeover defenses and the company's overall governance record in deciding whether to support the board's position, but will also require the poison pill to include the following "watered-down" provisions:

- A trigger no lower than 20 percent of the company's shares.
- A term of no longer than three years.

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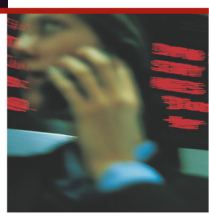


- No dead-hand, slow-hand, no-hand or similar feature that limits the ability of a future board to deactivate the poison pill.
- A qualifying offer clause (which provides that if the board refuses to deactivate the poison pill within 90 days after a qualifying offer is announced, the holders of 10 percent of the company's shares may call a special meeting to vote on rescinding the poison pill).

***Considerations***

In considering whether to adopt a poison pill, a company should evaluate its shareholder base and the likelihood that its shareholders will follow the voting recommendations of RiskMetrics or other advisory firms. If the company's shareholder base is not likely to be heavily influenced by RiskMetrics, the company, particularly if it has a modest market capitalization, should consider adopting a more potent form of the poison pill. If the company has a large institutional shareholder base that likely will follow RiskMetrics, the company can adopt a poison pill and make the case to its shareholders for approval. Such a company will have to decide whether to adopt a "watered-down" pill favored by RiskMetrics or a more protective pill. In either case, the company will likely face criticism and opposition. Another option is to prepare a poison pill tailored to the company's circumstances, but leave the pill "on the shelf" for adoption when the company is actually faced with a takeover threat or activist shareholder.

## RECENT TRENDS IN POISON PILL DESIGN

***Derivatives***

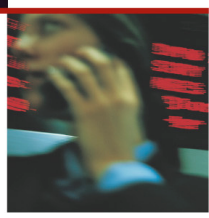
Many companies are including within the definition of the "beneficial ownership" that triggers a poison pill the ownership of derivate positions such as a "total return swap." Under a total return swap, a "short" party (usually a bank) agrees to pay a "long" party (usually a hedge fund) the returns from a particular stock in exchange for a fee. The bank usually holds an equivalent position in the stock as a hedge, and often votes the stock as requested by the hedge fund. The swap can usually be unwound in a way that allows the hedge fund to take ownership of the stock. Hedge funds often use total return swaps to avoid reporting their full ownership position in a company.

***Post-Trigger Safety Valve***

Another recent trend in poison pills is a "safety valve" that allows a board to waive the triggering of a poison pill after the ownership threshold has been exceeded. A post-trigger safety valve of at least 10 days is typical.

***Exchange Feature***

Many companies are also including provisions that allow a board, upon the triggering of the poison pill, to elect to exchange common stock for each right, in lieu of allowing the rights to be exercised



to purchase additional common stock at a discount. The exchange feature allows the board to effect the dilution of the triggering shareholder without the uncertainty of whether shareholders will actually exercise their rights and acquire shares at a discount.

## Placing Pre-Cleared Poison Pill "On the Shelf"

The process for placing a new poison pill on the shelf involves the following:

- A company should carefully select the design features for its poison pill, taking into account its own particular circumstances. A company may choose to design both "weak" and "strong" versions of the pill in an effort to be prepared for different kinds of potential threats.
- The poison pill should be pre-cleared with the financial institution that will serve as the rights agent.
- The Form 8-A that would be required to be filed with the SEC upon adoption of the poison pill should be prepared.
- No public announcement or SEC filing is required to announce the poison pill until it is formally adopted by the company's board.
- The company should review and update its poison pill from time to time to reflect design trends and other possible changes in the company's circumstances.

Companies should also continuously monitor their shareholder base for activist shareholders and potential acquirers, remaining vigilant of changes that would warrant taking the poison pill off the shelf.

## For More Information

If you have any questions, please contact: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