



IRRC

# IRRC Governance Research Service 2003 Background Report E:

## POISON PILLS

By Maria Carmen S. Pinnell, Esq.  
February 2003

- Background on shareholder rights plans, p. 2
- Variations on the pill, p. 6
- Shareholder proposals, p. 11
- Management proposals, p. 17
- History of shareholder activism on pills, p. 18
- Economic impact of poison pills, p. 31
- State law: rulings and legislation, p. 38
- Proxy voting guidelines, p. 44
- Definitions, p. 46
- Key to shareholder proponents, p. 46

### EXECUTIVE SUMMARY

The war over shareholder rights plans, commonly known as poison pills, remains intense for the third year in a row. Voting support for shareholder proposals to redeem or require shareholder approval for poison pills remains high. In 2002, anti-pill shareholder proposals won an average of 60.2 percent of shares voted. This figure is up from 57 percent in 2001, 61.9 percent of the shares voted in 1999, and from 57.5 percent in 2000.

The number of shareholder proposals on poison pills submitted reached record numbers in 2002, with a total of 81 shareholder proposals on poison pills tracked by IRRC. IRRC has voting results for 50 proposals that came to a vote. Thirty-six of the 50 proposals received majority votes and passed.

By comparison, in 2001, a total of 37 shareholder proposals on poison pills were tracked by IRRC. IRRC has voting results for 23 proposals that came to a vote. Seventeen of the 23 proposals received majority votes and passed.

Moreover, the number of shareholder proposals on poison pills being submitted is surging. IRRC is currently tracking 91 proposals asking companies to redeem or allow a shareholder vote on their poison pills for the 2003 proxy season. The large majority of the proposals for the 2003 proxy season are being submitted by individual proponents. As in 2002, long-time activist John Chevedden, as well as the Rossi family, appear to have made the elimination of poison pills one of their priorities in 2003. Their commitment to the issue may stem from the facts that the SEC is unlikely to allow omission of such proposals and that poison pill proposals usually garner higher votes than most other types of governance resolutions.

In general, shareholder proponents are seeking to rein in what they see as some of the worst aspects of pills. While the proposals usually ask companies to redeem or obtain shareholder approval of new or existing poison

pills, recently pill activists seem to be emphasizing the shareholder vote aspect of the proposal. In fact, in the past two years, proponents seeking shareholder approval of future pills, have submitted poison pill proposals to companies that currently do not have pills in place.

## Trends

- IRRC tracked 187 companies that adopted or extended shareholder rights plans in 2002. At 30 companies, poison pills are set to expire in 2003.
- 
- Last year, there were 81 shareholder proposals related to poison pills. (See Table 2.) In 2001, there were 37, in 2000, there were 38 proposals, while in 1999, there were 43 shareholder resolutions related to poison pills tracked by IRRC.
- 
- Currently, IRRC is tracking 91 precatory (nonbinding) shareholder proposals on poison pills. (See Table 1.)
- In 2002, poison pill proposals submitted by proponents received majority votes at a number of companies that do not have poison pills in place. The following is a list of companies that faced a shareholder proposal to redeem/vote on a poison pill in 2002 and do not currently have a poison pill in place. Note, some of these shareholder proposals did not actually come to a vote (they were omitted or not voted on for one reason or another): 3M, Airborne, AutoNation, Bank of America, Boeing, Bristol-Myers Squibb, Burlington Northern Santa Fe, Citigroup, Entergy, Exxon Mobil, General Dynamics, General Electric, General Motors, Honeywell International, Intel, IBM, Mattel, Occidental Petroleum, Sabre Holdings, Safeway, SBC Communications, Sears, Roebuck, TRW, UAL, Visteon, and Weyerhaeuser.
- As of the end of 2002, IRRC tracked approximately 2,176 U.S. companies with active poison pills. Of IRRC's core research universe of 1,944 companies, 1,088 have active pills.
- Despite the increased number of pills tracked, the proportion of larger companies with shareholder rights plans has been holding steady. Among S&P 500 companies, 60.0 percent had poison pills at the end of 2002, up slightly from 59.6 percent in 2001, and 59.1 percent at the end of 2000.
- Of the approximately 2,022 companies for which IRRC has trigger information, 512 companies (25 percent) have triggers of 20 percent, 1,319 companies (65 percent) have 15 percent triggers and 125 companies (6 percent) have 10 percent triggers.
- The use of binding bylaw amendments by shareholders has decreased over the past two years. In 2002, there were no binding poison pill shareholder proposals. In 2001, there was one binding poison pill shareholder proposal which was withdrawn before coming to a vote. In 2000, there were four binding shareholder proposals related to poison pills. Two of the four proposals, however, were withdrawn before coming to a vote. Currently in 2003, there are no binding shareholder proposals related to poison pills being tracked by IRRC.
- A number of companies adopted plans with Three Year Independent Director Evaluation (TIDE) provisions in 2002, including Aetna (which later redeemed its pill), Alliant Techsystems, Caterpillar, Morgan Stanley, Rawlings Sporting Goods, Vitalworks, and Washington Group International.

## I. BACKGROUND ON SHAREHOLDER RIGHTS PLANS

### What is a shareholder rights plan?

The U.S.-style poison pill was developed in the early 1980s as a defense against unwelcome takeover offers. Under a typical plan, shareholders are issued rights to buy stock at a significant discount from the market price. The rights are exercisable under certain circumstances, such as when a hostile third party buys a certain percentage of the company's stock. If triggered, the pill would dilute the value and voting power of the hostile party's holdings to such an extent that the takeover attempt presumably would never be made. Pills are not

intended to be triggered, but rather serve as a “doomsday” machine to deter any hostile takeover, and force would-be acquirers to deal with the board of directors.

Boards are not required to get shareholder approval to adopt poison pills, and they rarely do so. When directors do seek such approval, they can be successful, as were the boards of Vans in 2000, Adaptive Broadband in 1999 (shareholders approved “chewable” features of the company's poison pill), Texaco in 1998, and Horizon Mental Health Management in 1997. However, shareholders at Government Technology Services defeated that company's pill proposal by a 59 percent to 41 percent margin in 1997. In 2001, there was no management proposal to adopt a poison pill in IRRC's core research universe. In 2002, there was one management proposal to adopt a poison pill which was presented by McDermott International.

The poison pill is one of the most potent type of corporate takeover defense. The earliest form of a poison pill was a preferred stock plan adopted by several firms in 1983. In 1984, these were replaced by shareholder rights plans, which involved the issuance of rights rather than actual stock, so that they did not have an immediate impact on the corporation's balance sheet.

Attorney Martin Lipton, of the New York City law firm of Wachtell, Lipton, Rosen & Katz, is credited with inventing the modern poison pill. Lipton said the purpose of the pill was to give the board “a gate that it could control.” In a memorandum on the issue, Wachtell Lipton says “the basic objectives of the rights plan are to deter abusive takeover tactics by making them unacceptably expensive to the raider and to encourage prospective acquirers to negotiate with the board of directors of the target rather than to attempt a hostile takeover.” Martin Lipton considers a combination of a poison pill and staggered election of directors as the key takeover defenses. Staggered elections prevent a would-be acquirer from winning a board majority in a single board election; winning such a majority can be the only way to redeem a pill.

Use of shareholder rights plans spread rapidly after the Delaware Supreme Court's November 1985 decision, *Moran v. Household International*, 500 A.2d 1346 (Del. 1985), upheld the authority of a board to adopt a poison pill without shareholder approval.

Pills come in a variety of forms, but all of them entitle the holders to special rights if the pill is triggered by a takeover attempt. Under a typical plan, shareholders are issued rights to purchase stock in their own company (a “flip-in” plan) or in the acquiring company (a “flip-over” plan) at a discount rate (usually half price) if a hostile bidder acquires a certain percentage of the outstanding shares—usually 10, 15 or 20 percent. (The bidder has no such rights.) Such discounted purchases of stock by shareholders would dilute the value of the acquirer's stake to such an extent that it would be fatal (i.e., prohibitively expensive)—like swallowing a poison pill—to go forward with the acquisition.

In practice, pills are never triggered; rather, their existence forces would-be acquirers to negotiate with the board—thus giving the directors virtual veto power over an offer, critics say. Companies say pills protect shareholders from two-tier, too low or other “abusive” offers by giving the board time to negotiate for a better offer; but opponents say they often result in offers rejected or never made in the first place, or management entrenchment, all to the detriment of shareholders.

The rights are usually issued as a dividend on common stock, and the board retains the right to redeem them at a nominal price to accommodate a friendly acquisition or management buyout.

The pill upheld by the Delaware court in the *Household International* decision was a flip-over plan. However, in order to deal with cases where the acquirer did not actually consummate the business combination that would trigger a flip-over, flip-in pills were developed. Today, most poison pills contain both flip-over and flip-in provisions. Flip-in plans are generally regarded as more restrictive than flip-over plans. In fact, studies have indicated that shareholder rights plans with a flip-in provision may depress stock prices by a larger percentage, on average. (See definitions, page 46.)

Changes in takeover strategies have led to a number of enhancements to the plain-vanilla shareholder rights plan:

- Some pills have a so-called “back-door” redemption clause, which allows the board to redeem the pill after the triggering threshold is passed; some investors believe such clauses benefit them by giving a board more room to negotiate with a hostile bidder. (Some pill experts warn against such a clause, since it can create pressure on the board to redeem the rights in a game of chicken with the would-be acquirer.)

- Some firms have added a requirement that to redeem the pill, the continuing or disinterested directors must agree (i.e., a “dead-hand” pill); thus, an acquirer could elect directors to a board through a proxy fight and still might be unable to get rid of the pill. As discussed in Section VII of this report, there is tremendous controversy over such provisions, which only two years ago appeared in about one-fifth of rights plans. Furthermore, in 1998, Delaware courts held the provisions invalid under Delaware law. Now, however, many companies have eliminated the dead-hand provisions of their poison pills.
- In recent years, an “adverse person” clause has been added to many poison pills. An adverse person clause authorizes the board to trigger the flip-in provision of its poison pill against a substantial shareholder (usually 10 percent or higher) even if the regular trigger is higher, if the board determines the shareholder is acting or is likely to act in such a way as to have a “material adverse impact on the company.”

IRRC is not aware of any shareholder rights plan that has ever been triggered and allowed shareholders to exercise their rights under the plan.

## Poison pill adoptions and renewals

Poison pill plans grew slowly at first, and then rapidly following the *Household International* decision. IRRC knows of only seven companies that adopted pills in 1984. IRRC tracked 41 companies that adopted them in 1985; 306 in 1986; 143 in 1987; 354 in 1988; and 347 in 1989.

The numbers fell off after that date, until 1995, when a new merger wave caused the pace of new pill adoptions to pick up, and in 1996, when a large number of pills came up for renewal for the first time. (Most pills have a 10-year life span.) By IRRC’s count, the number of poison pill adoptions and extensions went from 133 in 1994 (including 112 new pills) to 249 in 1995 (including 207 new pills); 452 in 1996 (including 308 new pills); 435 in 1997 (including 350 new pills); 546 in 1998 (including 372 new pills) and 396 in 1999 (including 256 new pills). For this purpose, IRRC counts replacement of one plan with a new plan as an “extension.”

As these numbers indicate, 1998 was by far the largest single year for poison pill adoptions and extensions. These numbers include not only U.S. pills, but those adopted in Canada and at a few companies incorporated in Bermuda.

As of the end of 2002, IRRC tracked approximately 2,176 U.S. companies with active poison pills. Of IRRC’s core research universe of 1,944 companies, 1,088 have active pills. There were 157 new pills adopted and 30 pills extended in 2002.

- In 2001, IRRC tracked approximately 2,064 U.S. companies with active poison pills. Of IRRC’s core research universe of 1,912 companies, 1,053 had active pills. IRRC tracked 265 companies that adopted or extended shareholder rights plans in 2001.
- In 2000, IRRC tracked approximately 2,016 pills at U.S. companies. Of IRRC’s core research universe of 1,881 companies, 1,009 had active pills. IRRC tracked 225 companies that adopted or extended shareholder rights plans in 2000.

## Triggers

- In 2002, of the approximately 2,022 companies for which IRRC has trigger information, 512 companies (25 percent) have triggers of 20 percent, 1,319 companies (65 percent) have 15 percent triggers and 125 companies (6 percent) have 10 percent triggers. (See Figure 1.)

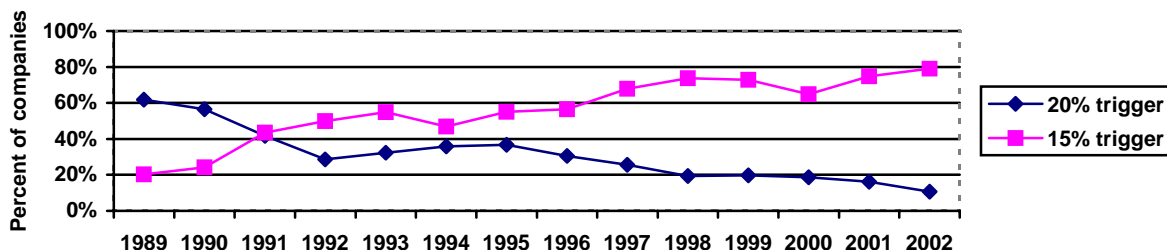
Of the 412 companies that adopted pills in 1989-91, that IRRC has trigger information on, 57.5 percent set the acquisition trigger at 20 percent, and only 24.5 percent set the trigger at 15 percent. For the 509 companies first adopting pills in 1996-97, that IRRC has trigger information on, these positions reversed, with 62.9 percent of companies using the 15 percent trigger and only 27.7 percent the 20 percent trigger. By 1998, 233 out of 316 new pills for which IRRC had trigger information (or 74 percent) were using the 15 percent threshold. In 1999, 166 out of 228 new pills for which IRRC had trigger information (or 72.8 percent) used a 15 percent trigger, while only 45 pills (or 19.7 percent) used a 20 percent trigger.

At present, advisors are recommending triggers as low as 10 percent. Out of the 187 companies that adopted pills in 2002, 20 companies (10.6 percent) have triggers of 20 percent, 148 companies (79.1 percent) have triggers of 15 percent and 5 companies (2.6 percent) have triggers of 10 percent.

Out of the 217 companies that adopted pills in 2001, 35 companies (16.1 percent) have triggers of 20 percent, 162 companies (74.7 percent) have triggers of 15 percent and 9 companies (4.1 percent) have triggers of 10 percent.

Out of the 225 companies that adopted pills in 2000, 42 companies (18.6 percent) have triggers of 20 percent, 146 (64.8 percent) have triggers of 15 percent and 19 companies (8.4 percent) have triggers of 10 percent.

**Figure 1: Acquisition triggers for poison pills, by year of adoption**



**Adverse person clauses:** A number of companies have adverse person clauses in their poison pills that allow the board to set the trigger figure at a low percentage (10 percent is the norm but a level of 5 percent is possible) for a shareholder who is judged likely to have an adverse impact on the company through holdings that meet or exceed that level.

Such low thresholds can create difficulties for some investors that are willing to take large positions but who may not be interested in acquiring, or sparking the acquisition of a company. Such investors may shy away from the 10 percent figure without a very clear signal from the company that they would not be regarded as an adverse person.

Some companies will change their triggers depending on the size of positions taken by particular investors, as well as on takeover fears. For example, in late December 1999, Bethlehem Steel dropped the trigger on its pill to five percent one week after WHX disclosed it held a 1.6 percent stake in Bethlehem Steel and made filings with regulators indicating it might seek a merger with or acquisition of Bethlehem Steel.

Bethlehem Steel stated that it reduced the trigger of its poison pill to 5.0 percent for parties that had made a Hart-Scott-Rodino filing, which is the filing WHX made. According to Bethlehem Steel, the general pill threshold for other parties remained at 15 percent.

**Company nearly triggers pill:** In an unusual occurrence, Gryphon Holdings nearly triggered the separation of the rights created by its poison pill in 1998. Gryphon, which faced a hostile takeover bid from privately held Markel, amended its pill in July 1998, to lower the threshold for the definition of an “acquiring person,” theoretically making Markel, a 10 percent holder, subject to that label. The pill provided that 10 business days after public announcement that an individual or group has acquired a 10 percent interest, the rights separate from the shares, and should be distributed and begin trading separately.

However, this unusual development did not kick in provisions of the pill because the Gryphon board did not take action to declare Markel an acquiring person. Markel went to court contesting the provision, and criticizing Gryphon’s unwillingness to clarify the provision. Gryphon clarified the provision in November 1998, by stating that its July amendment was unintentionally ambiguous and increased the ownership threshold to 11.8 percent to exempt Markel at its then-current level of ownership.

## II. VARIATIONS ON THE PILL

Over the years, a variety of modifications to shareholder rights plans have been suggested, either to satisfy critics and lessen shareholder opposition, or to strengthen the pill as a takeover defense.

Suggestions to make pills more palatable have included submitting pills to shareholder votes—a route seldom taken in the United States; creation of so-called “chewable” pills, which establish qualified offers that would not trigger the rights; shorter terms for pills and sunset provisions; and greater reliance on independent directors to help assure shareholders that pills would be put to good use. The shareholder proposals submitted in 1996-98 by shareholder activist Guy Wyser-Pratte—to Wallace Computer, Rexene, Pennzoil and Telxon—feature elements of these provisions.

Among variations that can strengthen a pill as a takeover defense are continuing director provisions that allow pills to be redeemed only by directors already on the board; lower triggers; and adverse person clauses.

### Second generation pill

As shareholder opposition to poison pills grew, attorney Martin Lipton in mid-1987 introduced a “second-generation” pill. It combined both flip-in and flip-over provisions and was in fact stronger than his original version, but it also offered a “shareholder referendum” on a takeover offer, at the request of the bidder. To take advantage of this provision, a bidder could not hold more than 1 percent of the company’s shares; it must offer to buy all of the shares, for cash, at a fair price; it must have financing or financing commitments; and it must pay half the costs of the special meeting called to vote on the offer. The meeting would be held 90 to 120 days after the bidder requested it—giving the company a substantial period to marshal its forces against the bid or seek another offer. If a majority of the outstanding shares voted in favor, the poison pill would be redeemed and the bidder’s offer (or a competing offer) could go forward.

Lipton said the shareholder vote idea was a direct response to investors’ complaints about existing pills. However, many institutional investors were cool to the idea. They said they doubted bidders would ever use the voting provision, so it would be of little value.

In 1990, the concept of a shareholder referendum on a pill fell out of favor with Lipton and, according to *Corporate Control Alert*, a number of companies advised by Wachtell, Lipton, Rosen & Katz dropped the provision from their pills.

### Chewable pill

Following Lipton’s second-generation pill, a number of proposals making pills inapplicable (or inapplicable without shareholder approval) to certain kinds of offers have been proffered, and a few companies have adopted one form or another of what has been dubbed a “chewable” poison pill. The chewable pill is constructed so it presumably will not stand in the way of an offer that a publicly traded target cannot refuse. The chewable pill is designed to “dissolve” when a supposedly respectable offer is on the table.

The idea of the chewable poison pill has been vigorously advanced by both Guy Wyser-Pratte and the State of Wisconsin Investment Board.

Critics say the chewable pill “is a flawed and incomplete solution,” as Pfizer officials Terence J. Gallagher and Walter T. Gangl and retired Delaware Chancery Court Chancellor William T. Allen wrote in a May 1998 letter to *The Wall Street Journal*. The trio were attacking the chewable pill that Wyser-Pratte urged on Pennzoil—a variant of which Pennzoil adopted as part of its negotiated settlement defusing the Wyser-Pratte proxy fight. The Wyser-Pratte proposal would have nullified the pill in the face of an all-cash offer for 100 percent of the company stock at a price at least 25 percent above the market value.

Gallagher, Gangl and Allen argued that the real solution is a genuinely independent board that will look out for the interests of the shareholders. The Wyser-Pratte chewable pill, they say, “takes the decision about the merits of an all-cash takeover offer out of the board’s hands,” setting an arbitrary 25 percent premium that could well become the going premium for cash takeovers. They say that in a number of transactions, standard pills have helped to push premiums well above 25 percent. Moreover, say Gallagher and associates, the chewable pill as generally proposed would fail to force a board to act on a stock-for-stock offer or a cash-and-stock bid, which are much more common than all-cash offers. Even in these settings, though, the 25 percent premium threshold might set an “artificially low” expectation for the premium.

In arguing for the Wyser-Pratte shareholder rights bylaw amendment, Cornell Law School professor Jonathan R. Macey (a Wyser-Pratte nominee for a Telxon board seat) argued that the chewable pill is “far more beneficial to shareholders” than the standard pill. Macey argued that chewable pills give target company managers added leverage to negotiate higher prices from outside bidders. He criticized standard pills as “show-stoppers used to block takeovers.”

**Calpers’ proposal:** In early 1989, the California Public Employees’ Retirement System (Calpers), an early leader of the shareholder campaign against poison pills, floated its own version of a shareholder rights plan that might be more palatable to shareholders. The Calpers chewable pill provided for a shareholder vote on takeover offers, at the bidder’s request, and required the board to redeem the pill if the offer was approved. However, the plan was less restrictive than Lipton’s; the bidder could hold up to 20 percent of the firm’s stock, compared with 1 percent under Lipton’s plan, and would have to pay only 80 percent cash, not all cash. The bidder would still have to pay half the cost of the special shareholders’ meeting and to have cash or written financial commitments to complete the deal.

Calpers said it was not pushing or promoting the new pill, but simply suggested it “in a spirit of compromise” to several firms with which the fund was negotiating over the withdrawal of poison pill shareholder proposals. One firm had asked Calpers to suggest a plan that would be generally acceptable to shareholders and would still give the board time to negotiate on a takeover bid, fund officials said. Although none of the companies adopted it, the fact that it was offered was seen to indicate that the large institutional investor found the idea of a shareholder vote on a takeover offer attractive enough to overcome its objections to poison pills.

**Adaptive Broadband vote:** In 1999, following an extensive review of its existing shareholder rights plan, Adaptive Broadband (formerly California Microwave) adopted a new poison pill with shareholder-friendly features. While its new poison pill was not subject to shareholder approval in its entirety, the company did give shareholders the opportunity to vote on key features of the new rights plan. In particular, the company permitted shareholders to vote on a chewable feature and the use of preferred stock in connection with the rights plan, rather than common stock. The proposal received support from 90.1 percent of the votes cast.

In a company release, Adaptive Broadband’s chairman and CEO Frederick Lawrence said, “while we believe that rights plans need to be considered carefully, we may be an attractive acquisition target, and feel it prudent to continue a rights plan. We also feel it is only fair to tailor a permanent, stockholder-friendly plan.”

**Canadian ‘permitted bid’ pill:** In Canada, where companies are required by provincial law and local stock exchange rules to have their pills ratified by shareholders, companies in late 1988 began adopting pills that allow for a “permitted bid” to be put to shareholders. If approved, the bid can proceed without triggering the pill. The idea is similar to Lipton’s shareholder referendum idea. It was first proposed by Pegasus Gold in December 1988 and, according to Allinvest (now Fairvest) Group’s Fiduciary Investor Services, Toronto, it has been included in every Canadian pill adopted since then.

Alcan Aluminum’s plan is typical: It allows a holder of less than 5 percent of the voting shares who also meets other tests to present a takeover bid to the shareholders at a special meeting to be called for that purpose. If a majority of the shares (excluding the bidder’s) are voted in favor of the bid, it may proceed. The procedure allows time for the shareholders to make a fully informed decision, and for the board to evaluate alternative proposals in order to maximize share value, according to Alcan.

Toronto attorney Philip Anisman took a different view. In an article in Allinvest’s *Corporate Governance Review*, he said the permitted bid concept merely “invokes the aura of shareholder decision making, while retaining the full deterrent effect that poison pills were intended to provide.” Anisman argued that poison pills are not justified in Canada because Canadian law prohibits coercive two-tier bids, against which pills are claimed to guard shareholders. He also criticized some of the permitted bid procedures being adopted as too restrictive; he said they stack the deck for boards to defeat bids.

**Texaco’s ‘fair to shareholders’ pill:** To win support for the reorganization plan by which it emerged from bankruptcy in 1988, Texaco agreed to let shareholders vote on a charter amendment requiring the board to redeem its poison pill within a year and to have any new pill approved by the shareholders or certified by a nationally recognized investment bank to be “fair (to shareholders) from a finance point of view.” This amendment was adopted, and in the spring of 1989, Texaco’s board adopted a new pill, redeemed the old one, and put the new pill up for shareholder ratification. It was approved by 84.2 percent of the shares voted.

Texaco's pill allowed shareholders to consider any "qualified," fully funded, all-cash offer. The bid would have to remain open for at least 45 days to give the board time to examine competing bids or other alternatives. If the board does not accept the bid in that time, and a majority of the outstanding shares were tendered, the pill would automatically dissolve, without any requirement for a shareholder meeting. Texaco said the pill would deter two-tier offers and other "abusive takeover tactics" that poison pills originally were supposed to prevent, but would give shareholders, rather than the board, the final decision on a bid.

The Texaco pill was put up for another vote at the company's April 28, 1998 annual meeting. The pill was extended for only five years. The proposal encountered greater opposition this time, but it passed with 66 percent of the vote. Critics said the qualified offer provision is meaningless in the case of Texaco, since it is highly unlikely that anyone would emerge with a fully-financed, 100 percent cash offer for a company with a market capitalization of \$34 billion. Aside from the chewable feature, Texaco advertised that its pill has what is now a relatively high threshold of 20 percent, and it noted that it set no arbitrary premium that an offer has to reach in order for the pill to be withdrawn.

In 2001, Chevron merged with Texaco. Recently, the new company, ChevronTexaco, amended its pill to expire in November 2003, five years earlier than the initial expiration date.

### **Three year independent director evaluations (TIDE) pills**

A number of observers argue that the real issue is board independence, not specific takeover defenses. In their May 1998 argument against the Wyser-Pratte chewable pill, Pfizer officials Gallagher and Gangl and former Chancellor Allen wrote:

If shareholders believe their directors would sacrifice shareholder interests in a takeover situation, then they actually have an even more serious problem. Directors are also responsible for: 1) overseeing management, 2) monitoring management's legal compliance, 3) evaluating management's performance, and 4) setting management compensation and benefits. If a board is swayed by management's special interests, it cannot be expected to properly handle these other crucial matters.

In 1997, Pfizer developed a new pill linked to independent directors and to regular re-evaluation. The company called it the Three-Year Independent Director Evaluation (TIDE) plan. Company officials lobbied for the pill with institutional investors—many of whom appear to be well-inclined toward Pfizer both because of its outreach to investors on governance issues and because of its performance—and have sought to interest other companies in the idea of linking the pill to director independence.

In an agreement that led to the withdrawal of a shareholder resolution, SuperValu told shareholders it would require a committee of independent directors to approve any pill it might adopt in the future. In addition, J.C. Penney adopted a TIDE provision prior to the vote in 1999 on its poison pill. Also in 1999, Georgia-Pacific adopted a TIDE provision and removed a dead-hand feature from its pill; and Chubb adopted a yearly independent director review of its pill prior to the vote on Unite's 1999 shareholder resolution on the company's poison pill.

A number of other companies have begun adopting plans with TIDE provisions in recent years, including Aetna (which later redeemed its pill), Alliant Techsystems, Applied Materials, Caterpillar, Jostens, Marsh Supermarkets, Morgan Stanley, Rawlings Sporting Goods, Vitalworks, and Washington Group International.

The typical features of a TIDE plan include: (1) the requirement that the board consist of a majority of independent, outside directors; (2) the customary "flip-in" (at 15 percent) and "flip-over" (at 30 percent) provisions (with no "chewable" features that allow a raider to take the board out of the negotiations); (3) a corporate governance committee of the board (made up exclusively of independent directors), which can set its own agenda and retain advisors—such as legal counsel and investment bankers—as it sees fit; (4) a 10-year life with a review by the corporate governance committee at least every three years; (5) the provision that the corporate governance committee may review shareholder opinions about the plan, research concerning the company, market valuations of its stock, relative valuations of peer companies, developments in rights plans since the last extension, the market for mergers and acquisitions and other factors it deems relevant and; (6) the provision that this committee may determine and then recommend to the entire board whether it believes it is in the best interests of the company and shareholders to redeem, amend or keep the pill as is. Pfizer also took certain other actions, such as eliminating an earlier continuing director provision.

## **Dead-hand poison pill provisions**

In the last few years, considerable attention has been focused on continuing director provisions known as “dead-hand provisions,” which turn shareholder rights plans into what are pejoratively called dead-hand pills. Under a dead-hand pill, only the directors in place at the time the pill is installed, or their designated successors, can remove the pill. Therefore, removing current directors does not help a hostile bidder, and in fact can put the company in a box, since that prevents redemption of the plan. The provision thus can foreclose the proxy fight option for a would-be hostile acquirer. Such provisions can substitute for lack of a classified board, or block proxy fights at firms that allow shareholders to call special meetings or act by written consent to remove directors.

Nearly 40 percent of larger U.S. companies elect all directors annually, the approach strongly preferred by many institutional investors. Since it generally requires shareholder action to stagger election of directors, and since shareholders are hostile to the idea, few large public companies are prepared these days to seek to classify their boards. A dead-hand pill, like all shareholder rights plans, can be adopted without shareholder approval.

Since 1998 many companies have eliminated the dead-hand provisions in their poison pills, including Georgia Pacific, Edison International, Marriott International, and Toys ‘R’ Us. Much of this change can be attributed to TIAA-CREF’s successful campaign against dead-hand poison pill provisions which began that year. Over the last three years, TIAA-CREF has asked 60 companies to remove their dead-hand pill provisions. Of those, 56 have removed the provisions from their poison pills; 53 did so before a resolution even came to a vote, and the remaining three companies did so after the resolution received strong shareholder support in a proxy vote. Two other companies were acquired and the issue became moot, leaving two companies that had not acted at the time.

Dead-hand provisions were dealt decisive set-backs in two rulings in 1998 by Delaware courts. (See VII. State Law: Rulings and Legislation) In response to the rulings, companies incorporated in Delaware have been dropping their dead-hand provisions, including such companies as Adobe Systems, Burlington Industries, Ciena, Furon, Lexmark International Group, Martek Biosciences, MedImmune, Oak Technology, and Tandy. Dead-hand pills are legal in Georgia and Pennsylvania, and are invalid in New York and Delaware. Their validity in most other states is not clear.

Before the Delaware rulings, about one out of five poison pills had dead-hand provisions. Since the Delaware rulings, many companies, especially those incorporated in Delaware, have dropped dead-hand provisions from their poison pills.

## **TIAA-CREF’s campaign against dead-hand pills**

In 1999, TIAA-CREF focused virtually all of its activist resources on eliminating dead-hand poison pills. Later that year, the pension system approached 32 companies to encourage them to drop the dead-hand provisions in their poison pills. Out of the 32, all but five or six have eliminated their dead hand provisions, redeemed their poison pills or have promised to do one of these.

In 2000, TIAA-CREF also continued to wage battle against dead hand poison pills. During the 2000 proxy season, the pension system submitted resolutions to 17 companies asking for the removal of their dead-hand provisions. Of the 17 companies, 15 complied with this request, leading TIAA-CREF to withdraw its resolutions. In addition, the pension system raised the issue with 13 other companies, which then eliminated these provisions or eliminated their pills altogether without TIAA-CREF filing a shareholder resolution.

In 2001, TIAA-CREF submitted 14 shareholder resolutions on dead hand poison pills. Except for a resolution at Profit Recovery Group, which received 64 percent of votes cast, 13 were withdrawn when companies amended their pills to remove this provision.

In 2002, CREF filed three shareholder proposals to eliminate dead-hand poison pills. The proposals at two other unnamed companies were withdrawn after the companies took some type of action in response. TIAA-CREF submitted for the second year in a row a shareholder proposal to PRG Schultz International (formerly Profit Recovery Group) for consideration at the company’s May 15, 2002 annual meeting. The proposal did

not pass, receiving 38.5 percent of votes cast in 2002. In 2001, the proposal received 64.4 percent of votes cast. “By adopting a poison pill without shareholder approval, the current board unilaterally deprived shareholders of the traditional right to sell their shares to potential bidders. By adding the ‘dead-hand’ feature, we believe this board also denies appropriate decision making authority to a new board, elected by shareholders, to decide what is in the best interests of shareholders,” said TIAA-CREF.

PRG argued that the redemption of its poison pill would not be in the best interest of the company and its shareholders, unless shareholders approve a management proposal to amend the company’s articles of incorporation to provide that directors may be removed only for cause. In its proxy materials, the company said that following the majority vote on eliminating the company’s pill at the 2001 annual meeting, a special committee of the board examined the benefits of the pill and recommended to the board that the PRG poison pill be amended to eliminate the dead-hand provision. However, this amendment to the pill would be effective only if shareholders voted to amend PRG’s articles of incorporation to provide that directors may be removed only for cause. On March 12, 2002, the board approved the amendment to the pill, which would be effective upon shareholder approval of a management proposal to amend the articles of incorporation presented at company’s annual meeting. The management proposal received 87 percent of votes cast and the company eliminated the dead-hand provision.

### **Value enhancement pill**

On Feb. 12, 1999, Medaphis, (now Per Se Technologies), which is incorporated in Delaware, pioneered what is now called the value enhancement pill. The company enacted a shareholder rights plan that recognizes the right of newly elected board members to redeem a rights plan, but mandates a specific procedure that must be followed to redeem a poison pill. Medaphis’ pill dictates that if a third party gains control of a majority of the board seats through an election or solicitation not authorized by the current board, then for a period of 180 days, the rights plan shall be redeemable. To redeem the pill, however, the new board would be required to satisfy a number of conditions.

The Medaphis pill would significantly extend the time required to redeem the pill after a change in the composition of the board following a proxy contest, which could prohibit the rapid removal of a rights plan in order to facilitate an unsolicited offer for control of a company. Before redeeming the pill, the new board would first be required to implement “Value Enhancement Procedures.” These procedures require the board to take the following actions:

- *Select an independent financial advisor:* during the preceding year, this advisor could not have had any ties to a transaction that would be facilitated by the redemption of the pill and could not have provided services to, have been engaged by, or have been a financing source for, any party that is involved in a bid to redeem the poison pill in order to consummate an unsolicited offer.
- *Obtain an independent advisor’s opinion:* the new board would have to obtain an independent advisor’s view on whether redemption of the poison pill would serve the best interests of the company and its shareholders. If the advisor did not offer this opinion, the board would have to explain why such a statement could not be provided. (This step would be required regardless of whether or not there is a pending transaction dependent upon redemption of the rights plan.)

If a transaction is pending that requires redemption of the rights plan, the board must then “implement a best value procedure.” Under this procedure, the new board must establish and implement a process that the board and the independent advisor agree would result in the best value reasonably available to shareholders. The board also would be required to obtain a fairness opinion from its financial advisor saying that the transaction is fair to the company’s shareholders from a financial point of view. The board also would have to determine and then state (with the independent advisor’s confirmation) that it has no reason to believe that a superior transaction is reasonably available for the benefit of the company’s shareholders. To effect the transaction, the board then would be required to execute a transaction agreement and provide other documentation.

After completing the “Value Enhancement Procedures,” the rights plan could be redeemed by a majority of the directors then in office, but would require a public disclosure process. The disclosure process requires the new board to announce:

- the manner in which the value enhancement procedures were implemented;
- any material financial, business, personal or other benefit or relationship that each director and each affiliate of such director has in connection with any suggested, proposed or pending transaction with or involving the company;
- the individual vote of each director on the motion to redeem the rights plan; and
- the statement of any director who voted on the rights plan.

### III. SHAREHOLDER PROPOSALS

#### 2003 shareholder proposals to redeem and/or require vote on poison pills

A variety of shareholder proponents have waged war on shareholder rights plan since 1987. While the plans of shareholder proponents for the 2003 proxy season are not complete, shareholder resolutions related to poison pills will again be very hot in 2003.

Currently, IRRC is tracking 91 precatory (nonbinding) shareholder proposals on poison pills for 2003.

**Table 1:**  
**2003 shareholder proposals to redeem and/or require vote on poison pills**

<i>Company Name</i>	<i>Proponent</i>	<i>Status</i>	<i>Meeting Date</i>
3M	Rossi Family	pending #	May
99 Cents Only Stores	Chevedden, J.	pending	June
Actuant	Chevedden, J.	# omitted: b-2	--
Airborne	Chevedden, J.	pending	April 29, 2003
Alaska Air Group	Davidge, W.	pending #	May
Allegheny Energy	Chevedden, J.	pending ##	May
Allstate	Rossi Family	pending	May 20, 2003
American Water Works	Rossi Family	pending	May
AMR	Chevedden, J.	pending #	May
Atlas Air Worldwide Holdings	Chevedden, J.	pending #	June
AutoNation	Chevedden, J.	pending #	May
Baker Hughes	Rossi Family	pending	April
Bank Of America	Rossi Family	pending #	April 30, 2003
Boeing	Janopaul, J.	pending #	April 28, 2003
Boise Cascade	Naylor, B.	pending	April 17, 2003
Bristol-Myers Squibb	Rossi Family	pending	May
Burlington Northern Santa Fe	Rossi Family	pending	April 16, 2003
Burlington Northern Santa Fe	Naylor, B.	# omitted: h-3	--
Catellus Development	Rossi Family	pending	April
Caterpillar	Chevedden, J.	pending ##	April 9, 2003
ChevronTexaco	Rossi Family	pending	May
Circuit City Stores	AFSCME	pending	June
Citigroup	Chevedden Family Trust	pending	April 15, 2003
ConAgra Foods	Rossi Family	pending	September
Continental Airlines	Chevedden, J.	pending	April
CSX	Rossi Family	pending	April
Delphi	Chevedden Family Trust	pending	May 1, 2003
Dow Chemical	Rossi Family	pending #	May
Edison International	Rattner, R.	pending	May
El Paso	Rossi Family	pending	May
Electronic Data Systems	Chevedden Family Trust	pending ##	April 22, 2003
Energy East	Rossi Family	pending	June
Entergy	Rossi Family	pending	May

Exxon Mobil	Rossi Family	pending	May
FirstEnergy	Wolff, A.	pending #	May
Fortune Brands	Rossi Family	pending	April 30, 2003
General Dynamics	Chevedden, J.	pending	May
General Electric	Rossi Family	pending	April 23, 2003
General Motors	Chevedden, J.	pending	June 3, 2003
Genuine Parts	Rossi Family	pending #	April 21, 2003
Glatfelter	Rossi Family	pending	April 23, 2003
Goodyear Tire & Rubber	Rossi Family	pending	April
Great Atlantic & Pacific Tea	Rossi Family	pending	July
Hewlett-Packard	Rossi Family	pending ##	April 2, 2003
Home Depot	Chevedden, J.	pending #	May
Honeywell International	Naylor, B.	pending #	April 28, 2003
Hubbell	Rossi Family	pending	May 5, 2003
International Business Machines	Rossi Family	# omitted h-3	--
J.P. Morgan Chase	Rossi Family	pending	May
KeySpan	Rossi Family	pending	May
Kimberly-Clark	Rossi Family	pending #	April 24, 2003
Lockheed Martin	Chevedden, J.	pending	April
Marathon Oil	Rossi Family	pending	April 30, 2003
Mattel	Chevedden, J.	pending #	May 14, 2003
Maytag	Rossi Family	pending #	May 8, 2003
McGraw-Hill	Rossi Family	pending #	April 30, 2003
Mesa Air Group	Berberian, P.	awaiting tally	February 11, 2003
Moody's	Rossi Family	pending #	April 22, 2003
Newmont Mining	Rossi Family	pending	May 7, 2003
Northrop Grumman	Chevedden, J.	pending #	May
Northwest Airlines	Chevedden, J.	pending	May
Occidental Petroleum	Rossi Family	pending	April 25, 2003
Paccar	Chevedden, J.	pending	April
PG&E	Rossi Family	pending	April 16, 2003
Philip Morris	Rossi Family	pending	April 24, 2003
Pitney Bowes	AFSCME	pending	May 12, 2003
PPL	Rossi Family	pending	April
Praxair	Rossi Family	pending	May 22, 2003
R.H. Donnelley	Rossi Family	pending	May
Reynolds (R.J.) Tobacco Holdings	Rossi Family	# omitted h-3	--
Ryder System	AFSCME	pending	May 2, 2003
Sabre Holdings	Chevedden, J.	pending #	May 13, 2003
Safeway	Rossi Family	pending	May
SBC Communications	Rossi Family	pending #	April 25, 2003
Sears, Roebuck	Rossi Family	pending	May
Service Corp. International	Rossi Family	pending	May
ServiceMaster	Rossi Family	pending #	May 21, 2003
Southwest Airlines	Chevedden, J.	pending ##	5/14/2003
Thomas Industries	Gamco Investors	# omitted e-2	--
TRW	Chevedden, J.	pending	April
UAL	Rossi Family	pending	May
UGI	Rossi Family	pending	February 25, 2003
UST	Rossi Family	pending ##	May 6, 2003
Verizon Communications	Rossi Family	pending	April 23, 2003
Visteon	Chevedden Family Trust	pending	May
Walgreen	IBEW	awaiting tally	January 8, 2003
Weyerhaeuser	Rossi Family	pending ##	April 15, 2003
Woodward Governor	English, G.	awaiting tally	January 22, 2003
Wyeth	Rossi Family	pending	April 24, 2003
Yahoo	LongView	pending	April
Zimmer Holdings	Rossi Family	pending	May

# The proposal was challenged at the SEC.

## The challenge was rejected.

b-2 Proponent did not provide verification of stock ownership.

e-2 Resolution was filed too late for consideration.

h-3 Proponent did not have “good cause” for failure to present the proposal at the previous annual meeting; company may exclude proponent’s resolutions for the next two years.

i-7 Relates to the conduct of the company’s ordinary business.

## **Management Response to Shareholder Activism**

In 2002, a total of 81 shareholder proposals on poison pills were tracked by IRRC. IRRC has voting results for 50 proposals that came to a vote. Thirty-six of the 50 proposals received majority votes and passed.

Majority votes on poison pill proposals have elicited responses from companies in 2000, 2001 and 2002. Some companies allowed pills to expire, while at other companies shareholder friendly provisions were added to make pills more palatable. According to data tracked by IRRC, it appears as if companies generally are most responsive to majority votes on poison pill proposals than others that receive majority support. One reason for this may be that shareholder approval is not necessary to redeem pills or to add shareholder-friendly provisions to them.

Shareholder-friendly provisions can include three-year independent director provisions (TIDEs), which create a committee comprised of independent members of the board to review and evaluate the pill at least every three years. Sunset features that require periodic shareholder approval of a pill also are considered shareholder-friendly. Other companies respond by adding qualified offer provisions, which neutralize the pill under certain circumstances that are defined in the pill’s provisions, including a fully financed, all-cash offer from a would-be acquirer. Below are a few noteworthy examples:

In 2002, Aetna announced a number of corporate governance changes, including the termination of its poison pill. At Aetna’s 2002 annual meeting, the company was engaged in a proxy fight with Providence Capital and faced a poison pill shareholder proposal, submitted by Bart Naylor, which was not presented at the meeting. Aetna’s pill, which had a 15 percent trigger, as well a shareholder-friendly TIDE feature, terminated on October 31. Aetna’s board does, however, retain the right to adopt a new pill in the future without shareholder approval.

Alaska Air Group redeemed the company’s poison pill in response to pressure by shareholders including Providence Capital. Providence threatened the company with an anti-poison pill bylaw amendment and a proxy fight. Alaska Air’s pill was adopted originally in 1986 and renewed in 1996 for another 10-year term. The company says it will eliminate the pill by amending its current 2006 expiration date to April 15, 2002. Interestingly, the company never has been faced with a shareholder proposal requesting that the board redeem the pill or subject it to a shareholder vote. Great Lakes Chemical also redeemed its pill in response to pressure by Providence Capital in February 2002.

In 2001, Providence Capital launched a “Poison Pill Campaign” and conducted a town hall meeting focusing on a “Director Nomination Bylaw Amendment,” (DNBA), which the group considers a possible “cure” for poison pills. The amendment holds board members accountable for failing to respond to shareholder votes to redeem pills. Under the DNBA board members who have failed to approve the redemption of a pill within 180 days after passage of the shareholder proposal requesting pill redemption will no longer qualify for nomination for an additional term as directors, unless the board submits to the shareholders a binding resolution to abolish the poison pill. (See Section V. History of Shareholder Activism on Pills.) IRRC is not aware of any companies that are currently the target of a Providence Capital DNBA.

ChevronTexaco amended its poison pill to expire on November 23, 2003, five years earlier than the initial final expiration date. At its 2002 annual meeting, the company was faced with a poison pill shareholder proposal submitted by Nick Rossi, which received 49.4 percent of votes cast. ChevronTexaco’s pill had a 10

percent trigger as well as a shareholder-friendly TIDE feature. ChevronTexaco's board also has retained the right to adopt a new pill in the future without shareholder approval.

Cinergy adopted a number of corporate governance changes in the third quarter of 2002, including the termination of its poison pill.

Champion Enterprises shortened the final expiration date of its poison pill from February 2006 to December 2002. Neither Cinergy nor Champion Enterprises were the targets of poison pill shareholder proposals in 2002.

In response to a proposal submitted by Gamco Investors that received 55.6 percent of votes cast, Penton Media amended its pill to incorporate a "sunset provision," which would allow the pill to expire immediately after the company's 2003 annual meeting unless it is approved by shareholders at that meeting. The company's poison pill originally was adopted in 2000. The pill has a 20 percent trigger and, at the time of adoption, Gamco controlled 19.1 percent of the company's outstanding shares.

Gamco also was successful at Modine Manufacturing, where its proposal passed with 75.1 percent support. (The company reported voting results as shares present and represented, including abstentions in the totals.) The company redeemed its pill sometime after its 2002 annual meeting. Modine's poison pill originally was adopted in 1986 and was renewed in 1996. Gamco Investors, which is affiliated with Mario J. Gabelli and Gabelli Funds, argued that redeeming the pill or putting it to a shareholder vote encourages shareholder democracy and allows shareholders to decide for themselves whether the pill improves or undermines shareholder value. Modine's poison pill had a 20 percent trigger. At the time it was adopted, Gabelli Funds controlled 18.7 percent of the company's outstanding shares.

PolyMedica also amended its 2002 poison pill to include a "sunset provision," which gives shareholders the opportunity to vote to either redeem the pill or keep it in place at the company's first annual meeting following the completion of certain investigations. PolyMedica is the parent company of Liberty Medical Supply, which is being investigated by the U.S. Attorney's Office for the Southern District of Florida and U.S. Department of Justice on charges of health care fraud, improper revenue recognition and obstruction of justice. According to board member Herbert Denton, "We adopted the plan because we believe that PolyMedica's shares are currently undervalued, largely due to concerns about the ongoing Department of Justice investigations."

Toys 'R' Us announced it would shorten the expiration date of its poison pill from January 2008 to June 2006. The company was the target of a 2002 shareholder proposal which was omitted.

El Paso allowed its 1992 poison pill to expire in July 2002. The company was the target of a 2002 shareholder proposal from the Rossi family that received 63.8 percent of votes cast.

Duke Realty redeemed its poison pill, as one of several new corporate governance initiatives. In 2001, the company faced a shareholder proposal submitted by the Service Employees International Union, which received 51 percent of votes cast.

In 2002, poison pill proposals submitted by proponents received majority votes at a number of companies that do not have poison pills in place. The following is a list of companies that faced a shareholder proposal to redeem/vote on a poison pill in 2002 and who did not currently have a poison pill in place. Note, some of these shareholder proposals did not actually come to a vote (they were omitted or not voted on for one reason or another): 3M, Airborne, AutoNation, Bank of America, Boeing, Bristol-Myers Squibb, Burlington Northern, Santa Fe, Citigroup, Entergy, Exxon Mobil, General Dynamics, GE, GM, Honeywell International, Intel, IBM, Mattel, Occidental Petroleum, Sabre Holdings, Safeway, SBC Communications, Sears, TRW, UAL, Visteon, and Weyerhaeuser. Many of these shareholder proposals, however, did receive majority votes in 2002 including, Airborne, 3M, Boeing, Bristol-Myers Squibb, Entergy, Occidental Petroleum, Sabre Holdings, Safeway, Sears, Roebuck, Visteon, and Weyerhaeuser.

Although most of the shareholder proposals ask the company either to redeem their current pill or to subject any future pills to shareholder approval, this situation can make it more difficult for a company to respond to

shareholder concern over a pill that does not exist. Intel was confronted with a similar problem in 2001 when shareholder activist Nick Rossi approached the company about its approval process for adopting a poison pill (the company did not have one in place). Following this conversation, Intel's board adopted a statement of policy on the topic saying that it "shall seek and obtain shareholder approval before adopting any poison pill; provided, however, that this policy may be revised or repealed without prior public notice and the board may thereafter determine to act on its own to adopt a poison pill if, under the then circumstances, the board, in its exercise of its fiduciary responsibilities, including a majority of the independent members of the board, deems it to be in the best interests of Intel's stockholders to adopt a poison pill without the delay in adoption that would come from the time reasonably anticipated to seek stockholder approval." The policy is subject to an annual review by the Corporate Governance Committee.

Last month, Sabre Holdings, which was faced with a shareholder proposal that received 83.6 percent of votes cast, announced that it has adopted a poison pill policy on January 14, 2003 stating "the board believes that it is appropriate to seek shareholder approval for the adoption on any poison pill."

In 2001, two proposals that received majority votes were at companies that do not currently have poison pills in place. These proposals, at Actuant and Burlington Northern Santa Fe, asked the boards not to adopt future pills without shareholder approval. Interestingly, both companies were also targeted in 2002 with shareholder proposals. In Fact, Burlington Northern Santa Fe faced two shareholder proposals related to poison pills. (See Table 2.)

Two companies that were embroiled in bitter proxy fights in 2001 announced that they are reforming some of their corporate governance practices. Steven Woghin, senior vice president and general counsel for Computer Associates, told IRRC that his company will allow its poison pill to expire five years earlier than planned. The pill now will expire in November of 2006, instead of May 2011. At Lone Star Steakhouse & Saloon, where in July the CEO was ousted off the board by Guy Adams, the board has agreed to make some significant governance changes, including redeeming its poison pill.

**Table 2:  
2002 shareholder proposals to redeem and/or require vote on poison pills**

<i>Company</i>	<i>Sponsor</i>	<i>Outcome*</i>	<i>Passed</i>	<i>2001 Vote</i>	<i>Ownership Institution</i>	<i>Ownership D&amp;O</i>	<i>Under-performed S&amp;P 500</i>
3M	Rossi Family	58.2	yes	--	69.6	<1	yes
Actuant	Chevedden, J.	omitted	--	50.4	--	--	--
Aetna	Naylor, B.	not presented		--	77.1	1.5	yes
Airborne	Chevedden, J.	91.4	yes	71.4	68.2	4.7	yes
Allegheny Energy	Chevedden, J.	54.4	yes	55.9	41.1	<1	yes
Allstate	Rossi Family	62.5	yes	--	61.1	<1	yes
Atlas Air Worldwide Holdings	Chevedden, J.	omitted	--	--	--	--	--
AutoNation	Chevedden, J.	omitted	--	--	--	--	--
Avaya	Brandes Trust	omitted	--	--	--	--	--
Bank Of America	Rossi Family	omitted	--	--	--	--	--
Bethlehem Steel	Rossi Family	meeting cancelled	--	--	--	--	--
Boeing	Janopaul, J.	50.7	no	--	63.4	2.3	yes
Boise Cascade	Naylor, B.	72.4	yes	--	89.2	5.9	yes
Bristol-Myers Squibb	Rossi Family	67.6	yes	--	59.7	<1	no
Burlington Northern Santa Fe	Naylor, B.	withdrawn	--	68.9	--	--	--
Burlington Northern Santa Fe	Rossi Family	omitted	--	68.9	77.2	1.6	yes
Calpine	Plumbers, Pipefitters	61.2	yes	--	87.1	4.7	no
Caterpillar	Chevedden, J.	48.2	no	49.8	62.6	1.5	yes

ChevronTexaco	Rossi Family	49.4	no	--	0	<1	yes
Circuit City Stores	AFSCME	73.3	yes	--	70.5	2.6	yes
Citigroup	Chevedden Family Trust	omitted	--	--	--	--	--
Colgate-Palmolive	Rossi Family	not in proxy	--	--	--	--	--
Continental Airlines	Chevedden, J.	not in proxy	--	--	--	--	--
CSX	Rossi Family	62.5	yes	--	65.9	2.8	yes
Delphi	Chevedden Family Trust	57.7	yes	52.0	67.6	<1	n/a
Dominion Resources	Lane, E.	37.5	no	--	46.5	1.9	no
Dow Chemical	Rossi Family	omitted	--	--	--	--	--
Edison International	Schlossman, B.	withdrawn	--	--	--	--	--
El Paso	Rossi Family	63.8	yes	--	0	2.2	no
Electronic Data Systems	Chevedden Family Trust	69.1	yes	64.2	74.1	<1	no
Enron	Rossi Family	--	--	--	--	--	--
Entergy	Rossi Family	79.5	yes	--	72.8	<1	no
Exxon Mobil	Rossi Family	44.9	no	--	24.1	<1	no
FirstEnergy	Wolff, A.	omitted	--	--	--	--	--
Fortune Brands	Rossi Family	65.5	yes	--	62.6	1.3	yes
General Dynamics	Chevedden, J.	not in proxy	--	--	--	--	--
General Electric	Rossi Family	39.8	no	--	50.4	<1	no
General Motors	Chevedden, J.	42.8	no	41.5	54.3	<1	yes
Goodyear Tire & Rubber	Rossi Family	70.9	no	--	63.6	<1	yes
Hartmarx	Meinert, J.	72.8	yes	--	28.3	6	yes
Honeywell International	Naylor, B.	64.2	yes	63.2	64.5	<1	yes
IMS Health	Rossi Family	not in proxy	--	--	--	--	--
Intel	Rossi Family	withdrawn	--	--	--	--	--
International Business Machines	Rossi Family	33.4	no	--	49.6	<1	no
Kimberly-Clark	Rossi Family	62.8	yes	--	70.5	<1	yes
Marathon Oil	Rossi Family	71.7	yes	--	74.9	1.1	yes
Mattel	Gilberts	omitted	--	--	--	--	--
Maytag	Steiner, W.	58.7	yes	62.7	55.1	6.1	no
McGraw-Hill	Rossi Family	54	yes	--	72.8	1.2	no
Modine Manufacturing	Gamco Investors	76	yes	--	41.9	5.9	yes
Moody's	Rossi Family	not in proxy	--	--	--	--	--
Northrop Grumman	Chevedden, J.	omitted	--	52.4	--	--	--
Northwest Airlines	Chevedden, J.	45.8	no	41.1	50.6	33.4	yes
Occidental Petroleum	Rossi Family	72.8	yes	--	69.6	4.6	yes
Paccar	Chevedden, J.	48.3	no	--	45.4	6.9	no
Penton Media	Gamco Investors	55.6	yes	--	73.1	28.4	n/a
Pep Boys-Manny Moe & Jack	Chevedden, J.	omitted	--	--	--	--	--
PG&E	Rossi Family	66.6	yes	--	49.1	<1	yes
Pharmacia	Rossi Family	72.9	yes	--	69.5	<1	yes
Pitney Bowes	AFSCME	omitted		53.2			
PRG-Schultz International	TIAA-CREF	38.5	no	64.4	47.2	44.2	yes
Raytheon	Chevedden Family Trust	62.7	yes	72.6	4	<1	yes
Reynolds (R.J.) Tobacco Holdings	Rossi Family	omitted	--	--	--	--	--
Ryder System	AFSCME	72.8	yes	--	79	3.7	yes
Sabre Holdings	Chevedden, J.	83.6	yes	--	91.9	3.1	no
Safeway	Rossi Family	71.7	yes	--	76	4.8	no
SBC Communications	Rossi Family	not in proxy	--	--	--	--	--
Sears, Roebuck	Rossi Family	70	yes	--	71.9	<1	yes

Sempra Energy	Gilberts	omitted	--	--	--	--	--
Southwest Airlines	Gilberts	57.3	yes	64.3	73.3	2	no
Southwest Gas	Carpenter, J.	withdrawn	--	60.2	--	--	--
Standard Motor Products	Gamco Investors	31.9	no	40.0	50.3	44.3	yes
State Street	LongView	52.4	yes	--	74.6	1.3	no
Toys 'R' Us	Plumbers, Pipefitters	omitted	--	--	--	--	--
TRW	Chevedden, J.	omitted	--	--	--	--	--
UAL	Chevedden, J.	not presented	--	--	62.8	1.3	yes
Visteon	Chevedden Family Trust	63.6	yes	--	53.4	1	n/a
Walgreen	IBEW	50.4	no	--	56.3	1	no
Wells Fargo	Armstrong, G.	57.4	yes	--	61.4	1.1	no
Weyerhaeuser	Rossi Family	52.1	yes	--	66.6	4.6	yes
Wyeth	Rossi Family	67.1	yes	--	64	<1	no

\* Votes as percentages of votes cast for or against the proposals. Abstentions and broker non-votes are excluded. Some companies include abstentions in the official vote count, or require a majority or supermajority of outstanding shares for a proposal to win passage.

## IV. MANAGEMENT PROPOSALS

In the United States, state corporate law does not require shareholder approval of rights plans, and the vast majority of boards adopt shareholder rights plans unilaterally without shareholder approval.

However, in recent years, a few companies have sought shareholder approval of their pills. Some acted in response to high votes on shareholder proposals or other shareholder pressure, and some included the proposal in reincorporation or restructuring proposals without giving shareholders the opportunity to vote on the pill separately.

At its May 1, 2002 annual meeting, McDermott International sought shareholder approval of the company's poison pill. The proposal received 60.9 percent of votes cast. Following a majority vote on a pill proposal at its 2001 annual meeting, McDermott International adopted a new five-year pill that replaced a previous pill that expired in May 2001. While this appears to go against the shareholders' mandate, McDermott's new pill had a sunset provision that made the pill subject to shareholder approval at the company's May 2002 annual meeting. The five-year term of the new pill also was more shareholder friendly since most pills have a 10-year term. At the 2001 annual meeting, the company faced a poison pill proposal from the American Federation of State, County and Municipal Employees (AFSCME). The proposal passed with the support of 54.7 percent of the votes cast, and the company allowed the pill to expire. Since the initial vote, the company has been in negotiations with the proponent.

In 2001, there were no management proposals on poison pills among companies in IRRC's core research universe. Rawlings Sporting Goods, a company not in IRRC's core research universe, redeemed its pill following a shareholder proposal in 2000 that received majority support and a management proposal in 2001 that failed to garner majority support. Following the 2000 shareholder proposal, Rawlings submitted a binding management proposal at its May 2001 annual meeting that sought shareholder approval of its poison pill. Rawlings' proposal did not receive the majority support of shareholders, and the pill was redeemed by the company on December 31, 2001.

In 2000, IRRC tracked one management proposal to adopt a poison pill at Vans. The State of Wisconsin Investment Board (SWIB) asked Vans to submit its poison pill to a non-binding vote of shareholders at the 1994 annual meeting and every three years thereafter. The pill passed in 1994 and 1997 with approximately two-thirds of the vote of shareholders. On Oct 24, Van shareholders ratified the pill for the third time since its inception. What makes the situation at Vans unique is that SWIB is no longer a significant Vans shareholder, having divested its holdings after the initial poison pill ratification. Vans corporate secretary Craig E. Gosselin

said the company decided to pursue approval of the pill anyway because it, “just figured it was good corporate governance.”

IRRC is aware that Atchison Casting, a company which is not included in IRRC’s core research universe, originally intended to ask its shareholders to ratify the adoption of a poison pill at its Nov. 17, 2000 annual meeting. On March 28, 2000, the company’s board passed the resolution adopting the poison pill, subject to ratification by shareholders. In a press release, the company said the poison pill is of such importance to shareholders that it was submitting it for their approval. However, the Nov. 17, 2000 meeting was postponed and instead held on June 29, 2001, despite the fact that Atchison Casting’s fiscal year ended June 30, 2000. The company postponed its scheduled November 2000 meeting after launching an investigation into accounting irregularities at its Pennsylvania Foundry Group unit. An April 24, 2001 report by the company said a small number of employees violated company policy, resulting in overstated revenue, income and assets, and in understated liabilities and expenses. The company later corrected its earnings statements to account for the findings of the investigation. The events at the Pennsylvania Foundry Group unit not only cast a shadow over operations at Atchison, but also managed to stymie the progress of adopting the company’s poison pill. The pill, which was eventually adopted, has a trigger at 20 percent ownership, a flip-in provision, a flip-over provision, and an exchange option.

In 1999, IRRC tracked no management proposals to adopt or redeem a poison pill (other than the vote on Adaptive Broadband’s chewable provision). Shareholders at Horizon Mental Health Management cast more than 62 percent of outstanding shares in favor of that company’s 1997 management proposal seeking approval. Yet that same year, shareholders at Government Technology Services defeated that company’s pill by a decisive margin, even though the pill would have had only a three-year duration. The management proposal was supported by 41.1 percent of shares voted for or against.

IRRC tracked no votes on management proposals to adopt poison pills in 1996. The 1995 season produced the first defeat for a management-proposed pill at a U.S. firm, when shareholders at Columbia Gas turned thumbs down on a proposal. But three other pills that year got high levels of support from investors.

Prior to the vote at Columbia Gas, only one U.S. company had been directed to drop its shareholder rights plan in response to a shareholder vote on a management proposal. That vote came at Ceridian in 1993. The company gave its shareholders a chance to provide a binding instruction to the board to move the pill’s expiration date forward by more than three years, to June 1, 1993. The proposal fulfilled Ceridian’s pledge to United Shareholders’ Association member Edwin Season, who withdrew a shareholder proposal hours before the 1992 meeting. The company’s proxy statement did not contain a supporting statement or a voting recommendation from the board. Instead, it contained a short description of the rights plan and a “pro and con” discussion of the impact of poison pills. Shareholders approved the proposal that the pill be allowed to expire in 1993, rather than in 1996 as scheduled, by a vote of 68.5 percent. Only 9 percent voted no and 22.5 percent abstained or did not vote. While the vote was not technically a loss for management, since it did not take a position on the issue, it was the first time shareholders voted to allow a management-proposed poison pill to expire early.

## **V. HISTORY OF SHAREHOLDER ACTIVISM ON POISON PILLS**

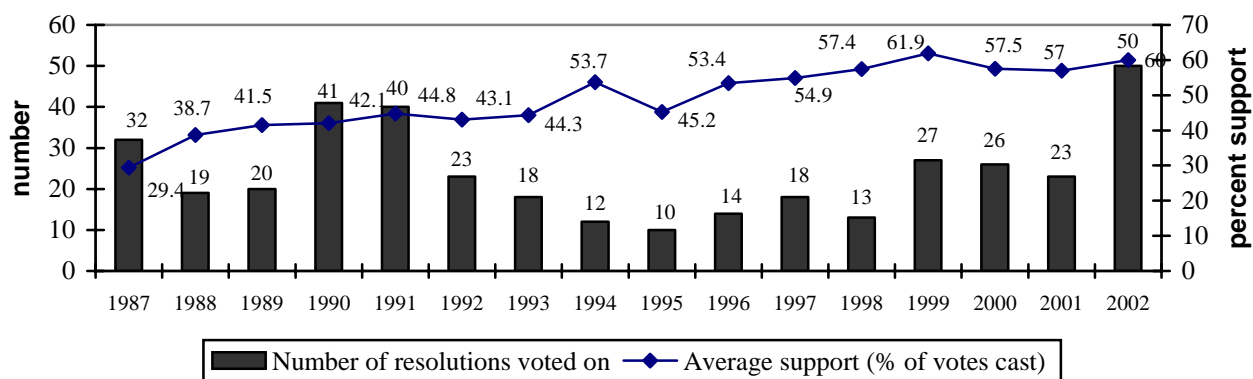
Until 2002, the high point of the anti-poison pill campaign, at least in terms of numbers of shareholder proposals on the subject, was in 1990-91, when shareholders voted 41 anti-pill proposals each year at companies in IRRC’s core research universe. (See Figure 2.) By 1995, only 10 proposals were included in proxy statements at U.S. companies. (These figures are for resolutions actually voted on; others were filed but withdrawn or omitted.) The number of resolutions appearing in proxy statements requesting companies to redeem and/or get shareholder approval for poison pills increased in 1996 (14 proposals) and 1997 (18 proposals). The number of shareholder proposals fell back to 13 in 1998, but increased dramatically in 1999 to 27 proposals. These numbers exclude one resolution in 1996 and four in 1997 that were not filed under provisions of the shareholder proposal rule. Also, IRRC did not include the 1999 Oregon Steel Mills proposal because it was submitted as a written consent proposal. The core IRRC research universe has increased over the years, from 1,200 in 1987 to 1,500 in 1988-1996, to 1,850 in 1997, to 2,000 currently. Beginning in 1998, IRRC sets its core U.S. research universe in the fall, and the number of companies declines in the course of the

year because of mergers and acquisitions. IRRC is aware of one further proposal at a company outside its core research universe—GRC International—that was voted on in 1998, which won a majority vote.

In 2002, 50 proposals of a total of 81 original proposals filed came to a vote.

The SEC has been clear that precatory proposals asking boards to redeem and/or require shareholder approval for poison pills are legitimate subjects for shareholder resolutions, and proposals generally have been omitted only on technical grounds (e.g. for being filed late). The status of binding proposals is less clear, and more of these resolutions may be omitted.

**Figure 2: Voting on shareholder resolutions to redeem or vote on poison pills at companies in IRRC's core research universe**



### Binding bylaw amendments: background

- Shareholder activists have been frustrated by a perceived lack of progress with the usual form of non-binding shareholder resolution. Consequently, they have sought to push the envelope by submitting binding bylaw amendments. The use of binding bylaw amendments by shareholders has decreased over the past two years. In 2002, there were no binding poison pill shareholder proposal. In 2001, there was one binding poison pill shareholder proposal which was withdrawn before coming to a vote. In 2000, there were four binding shareholder proposals related to poison pills. Two of the four proposals, however, were withdrawn before coming to a vote.

The question of whether shareholder-adopted bylaws on poison pills are valid under Delaware corporate law is still undecided by the courts and hotly debated by practitioners and academics. In fact, the Chief Justice of the Delaware Supreme Court has identified the legal validity of poison pill bylaws as one of the leading undecided questions under Delaware corporate law.

**Arbitrageur Guy Wyser-Pratte:** Wyser-Pratte submitted a bylaw amendment proposal to Wallace Computer Services in 1996. The proposal specified that if Wallace receives a cash tender offer representing a 25 percent premium and the board rejects such an offer, the board must call a shareholders’ meeting within 60 days to vote on the offer. If the management-sponsored resolution to reject the tender offer is not supported by a majority of votes cast at the meeting, the board must accept the tender offer.

This resolution came in response to the 1995 proxy fight between Wallace Computer Services and Moore. During that fight, Wallace, with the support of the Delaware court, used a “just say no” defense against Moore’s encroachments despite the fact that nearly 75 percent of Wallace’s shares were tendered to Moore’s offer.

The Wyser-Pratte proposal was supported by 48.9 percent of the shares voted, falling short of passage, but it sparked considerable interest. Wyser-Pratte himself followed up with similar proposals to Rexene in 1997, and to Pennzoil and Telxon in 1998. The Rexene proposal would have provided that if the company receives a fully financed tender offer, merger or other offer that includes at least a 25 percent premium over the average stock price during the 30 days preceding such offer, the board must terminate all defensive measures against the offer after 90 days unless shareholders vote to approve its opposition to the offer.

At Rexene, Wyser-Pratte's proxy fight for a dissident slate of directors and for shareholder proposals (including the pill proposal) apparently was headed for victory. Rexene postponed the meeting, and entered discussions about a sale of the company to Huntsman, which had sought to acquire Rexene for a number of months. (Rexene's earlier refusal to talk with Huntsman sparked the Wyser-Pratte fight.) Ultimately, Rexene agreed to be acquired by Huntsman.

Later in 1997, Wyser-Pratte was angered by Pennzoil's use of its pill to rebuff an all-cash offer from Union Pacific Resources Group. Pennzoil, which had adopted pills in 1985 and 1988, but had allowed them to lapse, adopted a new one in October 1994.

Wyser-Pratte's planned proxy fight at Pennzoil's May 7, 1998 annual meeting ended when the company entered into an agreement with Wyser-Pratte to implement a qualified offer provision, neutralizing the pill if a would-be acquirer obtains at least 66 2/3 percent of shares in a cash offer that provides a 35 percent premium over market price. The offer must stay open a minimum of 60 days. Pennzoil also adopted a bylaw giving shareholders the right to call a special meeting. At the same time, Pennzoil agreed to merge its products division with Quaker State.

In June 1998, after Telxon rejected an unsolicited \$40 cash offer from Symbol Technologies—representing a 25.7 percent premium over the trading price for the stock at the time—Wyser-Pratte said he would launch a proxy fight for a board seat at the company, which had tentatively scheduled an annual meeting in September. Wyser-Pratte also announced that he would propose a new variant of his shareholder rights plan binding bylaw amendment.

The bylaw amendment proposal would have allowed Telxon shareholders controlling 10 percent or more of the company's stock to call a special meeting to vote on any offer to acquire the company. A majority vote of the shareholders at a special meeting would have been able to deem the offer friendly rather than hostile, and the board would have been required to stop using its poison pill, which was renewed in 1997, to block the offer.

On July 13, Telxon filed a complaint in the United States District Court for Delaware, seeking an injunction declaring that Wyser-Pratte's acquisition bylaw and defensive action bylaw were invalid under Delaware law, and that the bylaw to opt out of Delaware's three-year freeze-out provision (Section 203) was not submitted in time for consideration at the Sept. 15 meeting. The company also said Wyser-Pratte's preliminary proxy materials were false and misleading.

On July 20, 1998, Wyser-Pratte moved for dismissal of the Telxon motion, or transfer of the motion to the U.S. District Court for the Southern District of New York. Subsequently, Wyser-Pratte had gone to court to force the company to provide him with its list of shareholders.

The fight was settled on Aug. 27, when Telxon agreed to accept any all-cash offer above \$40 a share or more than 140 percent higher than the 20-day average closing price of Telxon stock, whichever is greater. The company also agreed to appoint a new director to be approved by Wyser-Pratte. Wyser-Pratte declared victory, and said the settlement achieved his objectives "without the uncertainty and delay we would have faced if we had pursued the proxy contest and related litigation."

**Fleming proposal:** Labor union proponents have taken the lead on anti-pill shareholder resolutions, and have won high votes in many cases, with a number of the non-binding proposals passing. As many companies choose to ignore majority votes on non-binding proposals, union proponents decided to toughen their stance, and selectively propose binding bylaw amendments. Such proposals were filed in the last three years at Chubb, Fleming, Harrah's Entertainment, J.C. Penney, May Department Stores, Quaker Oats, SuperValu and U.S. West.

Six years ago, the Teamsters submitted a proposal to Fleming to redeem its poison pill or put it to a vote of shareholders. This proposal was precatory, and passed with 65 percent of the vote. Following the vote, management did not agree to redeem the pill or to put it to a vote. A new shareholder rights plan was enacted on July 6, 1996, to replace the expiring one.

Later in July, the Teamsters submitted a proposal for the 1997 meeting to amend Fleming's bylaws to redeem the company's poison pill, and to require that any future pill be approved by a majority of shareholders.

Fleming opposed putting this proposal on its proxy statement and wrote a request for a no-action letter to the SEC. Fleming said the proposal would require the company to violate Oklahoma law. According to the company, Oklahoma general corporation law empowers the board of directors to create and issue rights to common stock, unless there is a contrary provision in the company's certificate of incorporation. No such provision exists in Fleming's certificate of incorporation.

In addition to its letter to the SEC, Fleming filed a claim against the Teamsters in the District Court of Oklahoma County. The company asked the court for a declaratory judgment that the proposal was not a proper subject for a shareholder proposal because it was inconsistent with the company's certificate of incorporation and it violated Oklahoma law.

The Teamsters responded to the company's letter to the SEC with a letter of its own, and replied to the suit by Fleming with a countersuit. This countersuit sought a declaratory judgment that the shareholder proposal was proper under Oklahoma law. The Teamsters contended that under the state law, shareholders may adopt, amend or repeal bylaws and that this power may not be divested in a certificate of incorporation.

Judge Wayne Alley, of the U. S. District Court for the Western District of Oklahoma, relied heavily on policy considerations in reaching his decision. The judge emphasized that despite thick briefs by both sides, neither side had come up with a case from Delaware or Oklahoma that was "on point." "In the absence of precedent," he said, "extrinsic real world factors and policies have a proper role to play in the resolution of this issue."

**The decision:** The court ruled that Section 1038 of Oklahoma law gives power to the board concerning poison pills but that this power is not exclusive. The directors have a right to adopt a plan, Judge Alley said, but shareholders have a right to enact a bylaw giving themselves a right of review. The shareholder proposal, as Alley characterized it, provides that after the directors adopt a plan, "then the shareholders, through the device of bylaws, would have a right of review." Under the proposal, "the bylaws would be in effect indefinitely unless this particular bylaw got nullified or amended," he said.

Professor Lawrence A. Hamermesh of Widener University School of Law suggested this is a misreading of the shareholder proposal—that the proposal requires shareholder approval before a shareholder rights plan goes into effect, not the ability to nullify a plan after it takes effect. The shareholder proposal says the company "shall not adopt or maintain a poison pill" that makes acquisition of large holdings of stock more difficult or expensive "unless such a plan is first approved by shareholder vote."

More broadly, said Hamermesh, the Oklahoma decision "seems inconsistent with the allocation of responsibility between the board and shareholders" that currently prevails, at least in Delaware. He said the decision is "repugnant to the superior grant of authority" embodied in the company's certificate of incorporation.

In his ruling, Judge Alley said he was influenced by two considerations that "go beyond the face of the statutes." He was concerned that granting exclusive power over shareholder rights plans to directors puts the power "in that constituency in corporate governance that is most likely to be viewing the situation in light of self-interest." Second, said the judge, "the very purpose of a poison pill" is to produce "an effect on the marketability of shares," and, therefore, it is doubtful that this issue should be "beyond the cognizance of the shareholders, who are the people who really care about the marketability of shares."

Alley said that another factor "that exerts a tug...is the decision to ignore, or not to accept, the shareholder resolution which gained such a large majority vote on this question."

Fleming appealed the ruling, but included the binding proposal in its proxy statement. The proposal was subsequently approved by 61.9 percent of the shares voted, only a slight decline from a 1996 proposal that was supported by 65.0 percent of the shares voted.

The U.S. Court of Appeals for the 10<sup>th</sup> Circuit stayed an appeal, as questions of Oklahoma law raised by the case were pondered by the Oklahoma Supreme Court.

On Jan 27, 1999, the Oklahoma Supreme Court upheld the right of Fleming's shareholders to adopt a binding bylaw amendment. The court held that, "We find no Oklahoma law which gives exclusive authority to a corporation's board of directors for the formulation of shareholder rights plans." Additionally, the court ruled that there was nothing in Oklahoma corporate law, or existing case law, saying that shareholder rights plans are exempt from shareholder-adopted bylaws.

Fleming, relying on a section in the Oklahoma General Corporation Act, had argued that only the certificate of incorporation can limit the board's authority to implement a shareholder rights plan. In rejecting Fleming's argument, the court noted: "while this court might agree that a certificate of incorporation, which somehow precludes bylaw amendments directed at shareholder rights plans, could preclude the Teamsters from seeking the bylaw changes which are proposed in this case, neither party has indicated Fleming's certificate speaks in any way to the board's authority or shareholder constraints regarding shareholder rights plans."

However, the court did note that if Oklahoma corporate law contained a shareholders rights plan endorsement statute, the result of this case might have been different. Typically, these statutes take affirmative steps to ensure that domestic corporations, and in many instances the board of directors itself, are able to implement shareholder rights plans to protect the company from takeover. According to the court, "without the authority granted in such an endorsement statute, the board may well be subject to the general procedures of corporate governance, including the enactment of bylaws which limit the board's authority to implement shareholder rights plans." There are approximately 25 states with shareholders rights plan endorsement statutes.

Due to the similarity between the Oklahoma corporate statute dealing with shareholder adoption of bylaws and the Delaware corporate statute dealing with the same subject, some observers believe that the decision will serve as a guidepost for the Delaware courts if and when the issue of shareholder binding bylaws is litigated there. Nevertheless, there is skepticism in some quarters that the same reasoning would be followed by a Delaware court. Few companies are incorporated in Oklahoma, meaning that a decision narrowly confined to that state would have little broad impact.

Bartlett Naylor, then-Teamsters' director of corporate affairs, said the Fleming district court decision is "a national watershed victory for shareholders in most U.S. corporations" because it "strips away management's favorite entrenchment device." David R. Almond, senior vice president and general counsel for Fleming, said, "We believe this ruling is contrary to Oklahoma law on corporate governance, which was patterned after Delaware corporate law." Almond added: "Decisions related to share rights plans are clearly the prerogative of the board of directors."

**Georgia ruling:** In July 1997, the U.S. District Court for the Northern District of Georgia held that a binding bylaw shareholder proposal to Healthdyne Technologies was invalid.

The proposal to Healthdyne would have amended the company's bylaws to prohibit the company from including a "continuing director" provision in its shareholder rights plan. Healthdyne's provision, sometimes called a "dead-hand" measure, required that the redemption or amendment of the plan be approved by one or more of the directors who were members of the board before the adoption of the plan or who were subsequently elected to the board with the recommendation and approval of the other continuing directors.

In its ruling, the court said that under section 14-2-624(c) of the Georgia code (i.e., Georgia's poison pill endorsement statute), directors have the sole discretion to determine the terms and conditions of a shareholder rights plan. The proposed bylaw, said the court, "is actually an attempt to control the board of directors and directly interferes with the board's authority under section 624(c) to set the terms and conditions of the rights agreement." The court added that the bylaw is "inimical to the corporate structure contemplated by the Georgia Business Corporation Code, which separates the rights and duties of directors from those of the shareholders."

Georgia corporate law is somewhat favorable to takeover defenses, and contains a continuing director provision as well as a poison pill endorsement statute. As a result, it is unlikely the Georgia ruling would have great precedential value outside of the state.

## Recent binding bylaw proposals

Bylaw proposals mark a change in shareholder resolution activity, which has centered in the past on nonbinding proposals that request boards to take action. Mandatory proposals are often fueled by institutional investor anger over the number of shareholder resolutions that have been approved by a majority of shareholders but ignored by management.

***The Director Nomination Bylaw Amendment:*** In 2001, Providence Capital launched a “Poison Pill Campaign” and conducted a town hall meeting focusing on a “Director Nomination Bylaw Amendment,” (DNBA), which the group considers a possible “cure” for poison pills. The amendment holds board members accountable for failing to respond to shareholder votes to redeem pills. Under the DNBA board members who have failed to approve the redemption of a pill within 180 days after passage of the shareholder proposal requesting pill redemption will no longer qualify for nomination for an additional term as directors, unless the board submits to the shareholders a binding resolution to abolish the poison pill. (See Section VI. History of Shareholder Activism on Pills)

Navistar International, a company not in IRRC’s core research universe, redeemed its poison pill in October 2001, in response to pressure by Providence Capital, which threatened Navistar with a binding proposal and a proxy fight in 2002 if the pill was not redeemed. According to Bert Denton, president of Providence Capital, Providence was ready to submit proxy materials to include “a mandatory poison pill bylaw amendment as well as an alternate slate of director nominees for Navistar’s 2002 annual meeting.”

At its February 20, 2001 annual meeting, the company faced a shareholder proposal submitted by Gamco Investors asking the company to redeem its poison pill unless the pill was approved by a majority of outstanding shares. At the time, Gamco, which is Navistar’s second largest shareholder, controlling approximately 8.6 percent of the total voting power, said the board should redeem the pill or put it to a shareholder vote in order to improve shareholder value. The shareholder proposal at Navistar received 84.5 percent of votes cast.

According to Navistar chairman, president and CEO John R. Horne, “given current conditions in the economy and our industry, continued dialogue with our shareholders about the merits of the rights plan is neither productive nor relevant to the current challenges confronting our company, and accordingly, our board of directors determined it prudent to eliminate further such distractions.”

Providence next targeted Great Lakes Chemical. Facing a DNBA and an alternative slate of director nominees submitted by Providence, Great Lakes Chemical announced in early February 2002 it was eliminating its poison pill. Great Lakes originally adopted its pill in 1989, and later renewed it in 1999. “A number of our largest shareholders, and several others represented by Providence Capital, told us that they preferred we redeem the rights plan,” said Mark P. Bulriss, chairman and CEO. “In response, the board has decided to eliminate the plan for now.”

At the company’s 1999 and 2000 annual meetings, non-binding poison pill shareholder proposals received majority support. In 2000, the pill proposal, which was submitted by the Amalgamated Bank’s Long View Collective Investment Fund received 53.4 percent of votes cast; in 1999, the pill proposal received 63.2 percent of votes cast. The redemption of Great Lakes’ poison pill is effective as of the close of business on April 1, 2002.

Litigation challenging a boards’ authority to adopt a poison pill has been unsuccessful, particularly in Delaware. (See Section VII. State Law Governing Poison Pills.) While some commentators argue that the DNBA will be struck down by Delaware courts, others, including Michael Hanrahan, an attorney at Prickett, Jones & Elliott in Delaware, argue that there is substantial statutory and case law to support the DNBA.

In “The Next Poison Pill Antidote-Director Nomination By-Law Amendments,” *The Corporate Governance Advisor Jan/Feb 2002*, Hanrahan argues that support for the DNBA can be found in Section 109(a) of the Delaware General Corporations Law, which states: “the power to adopt, amend or repeal bylaws shall be in

the stockholders entitled to vote...provided however, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors...The fact that such power has been so conferred upon the directors...shall not divest the stockholders...of the power, nor limit their power to adopt, amend or repeal bylaws.” In addition, Hanrahan argues, the right to decide who will be on the board of directors is a power that unmistakably belongs to shareholders.

Furthermore, Section 141(b) of the Delaware code specifically provides for bylaws that establish qualification for directors without limitation. In fact, the leading Delaware case on point, *Stroud v. Grace*, holds that the range of permissible director qualifications is vast.

Many Delaware corporate practitioners maintain that a bylaw that restricts the ability of a board to adopt or maintain a poison pill would be invalid under Section 141(a) of the Delaware code, which authorizes the board of directors to manage the business of the corporation, unless the certificate of incorporation provides otherwise. Hanrahan, however, believes that the DNBA does not conflict with the Section 141 (a), because “unlike bylaws that seek to prevent poison pills, it is expressly authorized by section 141(b). When there is specific statutory authority for bylaws in a particular area, bylaw regulation in that area is of nearly unchallengeable validity.”

In addition, Section 109(b) says: "the bylaws may contain any provision, not inconsistent with the law or the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers, or the rights or powers of its stockholders, directors, officers or employees." Thus, until held otherwise by the Delaware Chancery Court, it can be argued that Section 109 authorizes bylaws that limit the board's authority with respect to poison pills. In either case, the interplay between Section 141(a) and Section 109 as they pertain to shareholder adopted bylaws concerning poison pills has not been resolved by the Delaware courts, and thus is still ‘unsettled’ under Delaware corporate law.

The battle over Chubb's poison pill, which was scheduled to take place on April 25, 2000, did not occur. The United Needletrades and Industrial Textile Employees (Unite) submitted a binding proposal that would have amended the company's bylaws to require that the company redeem its existing poison pill and prohibit the adoption of a new pill without shareholder approval. Despite plans to do battle at the meeting, the union learned late on April 24 that the local fund that submitted the proposal recently had liquidated its holdings of Chubb shares, preventing it from submitting the proposal again.

Unite filed suit in New Jersey federal court against Chubb in January 2000, and Chubb counter-sued in February 2000, challenging the company's refusal to let shareholders vote on Unite's 2000 binding poison pill proposal and Chubb's claim that Unite's proposed bylaw was illegal under New Jersey law (Chubb is incorporated in New Jersey). Originally, Chubb was going to omit the Unite proposal under Rule 14a-8(i)(1) of the Securities Exchange Act, which allows a company to exclude a shareholder proposal that is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's incorporation. However, Chubb subsequently included the proposal in its proxy materials.

Chubb maintained in its suit against Unite, that the bylaw change advocated by Unite is illegal under New Jersey law and therefore could not be implemented by the company and thus is null and void as a matter of law. Consequently, Chubb asked the judge in the case to rule that the proposed bylaw was illegal under New Jersey law.

Chubb argued that the Unite proposal was illegal because the shareholder rights endorsement statute in New Jersey “explicitly embraces the right of a New Jersey corporation to adopt a shareholder rights plan and entrusts this right (and the right to fix the terms thereof) to the corporation's board of directors, unless the certificate of incorporation provides otherwise.”

The company argued that because its certificate of incorporation does not restrict the authority of its board to adopt a rights plan or to fix the terms and conditions of the rights, the board has the exclusive authority to amend the terms of the corporation's outstanding rights plan and/or to adopt a new rights plan. Accordingly, Chubb argued that any limitation on the board's ability to amend, adopt or redeem a poison pill must be

contained in the company's certificate of incorporation and not the bylaws, as the Unite proposal attempts to do.

Nevertheless, prior to the scheduled vote on the binding proposal, the local fund that submitted the proposal announced that it had recently liquidated its holdings of Chubb shares, thus prohibiting Unite from presenting the binding proposal at the annual meeting. As result, O'Hare, a company spokesman, said Chubb would "seek to dismiss the lawsuit."

Chubb faced a similar proposal by Unite at its 1999 annual meeting. The 1999 proposal, which sought to amend the company's bylaws to allow shareholders to redeem or vote on the renewal of the company's poison pill, received support from 69.7 percent of the shares voted. Despite strong support for the proposal, Chubb refused to implement the bylaw because it said the bylaw amendment violated New Jersey corporate law.

In March 1999, Chubb's board of directors voted to redeem its poison pill, which was set to expire in June of 1999, and adopted a new pill that is due to expire in 2009. Chubb's pill provides that an independent committee would review the shareholder-rights plan at least annually and would review whether to recommend that the board redeem the rights if a fair offer for the company were to be presented.

Another binding poison pill proposal did not come to a vote in 2000. The LongView Collective Investment Fund scrapped its plans to pursue a binding poison pill proposal at Target. Cornish Hitchcock of LongView said his fund had reached an agreement with the company, under which Target will allow its poison pill to lapse when it expired on Sept. 26, 2001. If the company wishes to adopt another pill it would have to comply with a set of requirements specified by LongView, said Hitchcock.

Compaq Computer enacted a poison pill bylaw amendment that makes any future poison pill adopted by the company's board of directors subject to shareholder approval. The Communications Workers of America submitted a shareholder proposal in 1999 asking the company to adopt a similar bylaw amendment. The union fund withdrew the proposal after the Compaq board adopted the bylaw provision.

Compaq said its corporate governance committee, as part of its annual review of corporate governance standards, evaluated its shareholder rights plans in 1998. The committee recommended that the board clarify its support for shareholder approval of these plans. The board amended the company's bylaws to provide that a shareholder rights plan adopted by the board would be immediately effective and subject to shareholder approval at the next annual meeting.

Compaq's bylaw amendment appears to be a reaffirmation of a board policy adopted in 1996. Compaq, which adopted a poison pill in 1989, moved up the expiration date of the pill (originally set for May 1999) to Dec. 31, 1995. The company won the right to omit an anti-pill resolution for the 1996 proxy season from the Teamsters on the grounds that the plan's expiration made the resolution moot. The Teamsters pressed further, saying the proposal should have been included because it requested the redemption of any poison pill, either in existence or adopted in the future, which was not approved by shareholders. The Teamsters eventually agreed to drop the matter when Compaq agreed to put any future rights plans up to a binding shareholder vote within 12 months of its adoption.

Delaware, where the majority of publicly traded corporations are incorporated, has yet to decide the issue of whether shareholders may limit the power of a board of directors to adopt and amend a shareholder rights plan through a bylaw amendment.

The Oklahoma Supreme Court, however, has upheld the validity of a shareholder-proposed bylaw amendment that required the board of directors of an Oklahoma corporation to redeem its poison pill and refrain from adopting any future poison pill without shareholder approval. (See *International Brotherhood of Teamsters General Fund v. Fleming Companies*, 975 P.2d 907 (Okla. Jan. 26, 1999).) In its opinion, the Oklahoma Supreme Court recognized that its decision would have been different if Oklahoma corporate law contained a poison pill endorsement statute. As previously noted, New Jersey has a poison pill endorsement statute.

## Concession agreements

In 1999, the Amalgamated Bank of New York's LongView Collective Investment Fund won significant concessions from Mallinckrodt, St. Paul, and Time Warner on poison pills.

In 1998, the fund submitted a binding proposal calling for Mallinckrodt to redeem its poison pill or subject it to a shareholder vote. After submission of the proposal, the company and the fund exchanged a heated series of letters that addressed the question of whether shareholders could submit such bylaw amendments under the laws of the state of New York, where Mallinckrodt is incorporated.

Mallinckrodt agreed to either redeem the plan or to put it to a binding shareholder vote no later than the date of the 1999 annual meeting. In the end, Mallinckrodt's board decided to terminate its poison pill rather than put it up for a shareholder vote. The company's directors said they decided to redeem the rights plan to "avoid the distraction and expense" that would accompany a shareholder vote on the issue.

St. Paul and International Flavors & Fragrances also faced binding proposals on their poison pills from LongView. Management at those companies ultimately agreed to let their poison pills lapse on schedule. St. Paul's pill lapsed in December 1999, and International Flavor & Fragrances' pill lapsed on Feb. 20, 2000.

However, despite reaching an agreement with LongView to allow its poison pill to lapse, International Flavors & Fragrances renewed its poison pill. Early in 1999, LongView submitted a binding poison pill proposal to the company. In September of 1999, LongView said that management at the company had agreed to let the pill lapse on Feb. 20, 2000, and LongView, in turn, would withdraw its proposal. The pill did indeed lapse on that date, but the company renewed it on March 9, 2000. The new pill will expire in March of 2010. The company also reduced the new pill's trigger from 20 percent to 15 percent of the company's common stock.

Time Warner, which faced a precatory proposal, agreed to bring its poison pill to a shareholder vote at the company's annual meeting in 2000, or to redeem the pill before that time. (Time Warner wrote a letter dated Jan. 26, 2000, to LongView to say that when the company merges with America Online, the resulting AOL-Time Warner will not have a poison pill, and, in fact, AOL-Time Warner has not adopted a pill to date.

Georgia-Pacific amended its poison pill in July 2000 to drop a dead-hand provision and include in the pill a Three Year Independent Director (TIDE) feature. A TIDE provision creates a committee consisting of independent members of the board who will review and evaluate the pill at least every three years. This TIDE component requires an independent director evaluation to determine whether maintaining the poison pill continues to be in the best interests of the corporation, its shareholders, and other interested stakeholders.

A shareholder proposal submitted by LongView in 1999 to Georgia-Pacific, which asked the company to redeem its poison pill or subject it to a shareholder vote, received 71.7 percent of the votes cast, and 52.1 percent of the shares outstanding.

Cornish Hitchcock of LongView said his group did not threaten to reintroduce the proposal in 2000. "I think 70 percent sends a pretty strong message, and I'm glad that the board got that message, even if it did not go as far as we would have liked it to go." He explained that LongView would have preferred to see the board require that the pill be subject to a shareholder vote or be redeemed. Hitchcock did, however, give the company's board credit for dropping the dead-hand provision in the pill in a state where the court has upheld a company's right to have such a provision.

LongView was not successful at Great Lakes Chemical. Despite the fact that LongView's binding pill proposal received support from 63.2 percent of the votes cast, the company nevertheless renewed its poison pill.

The board of directors at GRC International accelerated the expiration of the company's poison pill and eliminated its dead-hand provision. The poison pill, which was set to expire Dec. 31, 2005, was terminated Aug. 31, 2000. The company said the action was taken in response to a 1998 shareholder proposal submitted by David and Joyce Corcoran asking the company to redeem or allow shareholders to vote on its poison pill. That proposal passed, receiving 67.1 percent of the votes cast.

At eGlobe, the board of directors took the initiative to repeal the company's existing poison pill in May 1999. "The pill gave sole authority to the board to trigger the pill and, in the view of the chief executive and the

board, built a defensive structure which principally protected the board and management," said a statement issued by the company.

In place of the poison pill, the board proposed an amendment to the company's certificate of incorporation. The amendment replaces the repealed poison pill with a provision that requires any party who has begun to gain effective control of the company, because of its ownership in the company's stock, to make a tender offer for the company. The amendment prohibits acquisition by any one person of more than 30 percent of the outstanding equity or 40 percent of the fully diluted equity of the company except through a qualified offer. The company defines a qualified offer as a fully financed, all-cash tender offer.

## **Challenges and SEC views**

Companies have been required by the SEC to include shareholder proposals in their annual meeting proxy statements since 1939.

Company challenges of anti-pill proposals on substantive grounds are rare. The SEC staff has consistently found that nonbinding pill proposals may not be excluded from proxy statements.

Even prior shareholder approval of a poison pill does not insulate a company from a shareholder proposal aimed at eliminating the pill. This was the message from the SEC staff in its 1992 letter to Dial saying the company could not omit a proposal asking it to redeem or allow a binding shareholder vote on its shareholder rights plan. The company had included approval of the pill as part of a spin-off proposal at a special meeting, and shareholders approved the bundled proposal.

Ever since the shareholder proposal rule was formally adopted in 1942, companies have been permitted to exclude a shareholder proposal if it "is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization." This exclusion is currently codified in Rule 14a-8(i)(1). According to Leonard Chazen, a partner at the law firm of Covington & Burling in New York, if a shareholder wants to propose action by shareholders on a subject that state corporation law reserves for the board of directors or is otherwise improper under state corporation law, the company may exclude the proposal from the proxy statement. However, under Rule 14a-8(g) the company has the burden of proof on whether it is entitled to exclude a shareholder proposal.

The Rule 14a-8(i)(1) exclusion is especially important when dealing with binding bylaw proposals that would mandate shareholder approval of matters commonly left to the board of directors, such as poison pills and the repricing of stock options. When attempting to exclude these proposals from their proxy statements, companies typically argue that the binding proposals are not a proper subject for shareholder action under state law because they would give shareholders powers that can only be exercised by the board.

Because the validity of these types of shareholder-adopted bylaws is undecided in many states, including Delaware, the SEC is left in the peculiar position of determining whether or not it should attempt to decide the state law question.

Prior to 1997, the SEC would, in some circumstances, attempt to answer undecided questions of state law. However, because shareholder proposals often raise unique questions of state law, the SEC did not have a settled body of judicial decisions to rely on. Consequently, there were occasional inconsistencies in the positions taken by the staff. The *Exxon* and *Pennzoil* letters, where the SEC apparently reversed its position on shareholders' power to require the company to create a shareholder advisory committee to review and evaluate the performance of the board, are probably the best known examples of these inconsistencies.

However, faced with the uncertainty of the binding bylaw issues, the SEC apparently decided in 1997 to eliminate the practice of deciding novel questions of corporate law in the realm of no-action requests. This change of policy was expressed in the no-action letter to PLM International, which sought to exclude a bylaw proposal setting a time limit on the board's use of the poison pill, without shareholder approval, against an offer. In the no-action letter the SEC wrote, "the staff notes in particular that whether the proposal is an appropriate matter for shareholder action appears to be an unsettled point of Delaware law. Accordingly, the Division is unable to conclude that rule 14a-8(c)(1) [now rule 14a-8(i)(1)] may be relied upon as a basis for excluding the proposal from the company's proxy materials." The SEC staff has not taken a position on unsettled questions of state corporation relating to poison pill bylaws ever since it issued the PLM International no-action letter.

Nevertheless, during the 1999 proxy season, the SEC appeared to subtly alter its position as enunciated in the PLM International no-action letter. This slight alteration can be seen in the staff's no-action letter to Eastern Enterprises. (Eastern Enterprises, a Massachusetts business trust, wished to exclude an amendment to its declaration of trust that was the equivalent to a poison pill bylaw.) In the Eastern Enterprises letter, the staff of the SEC wrote, "neither counsel for you nor the proponent has opined as to any compelling state law precedent. In view of the lack of any decided legal authority *we have determined not to express any view with respect to the application of rule 14a-8(i)(1)* [the "improper subject exclusion"] *to the revised proposal.*

The Eastern Enterprises letter tends to imply that there has to be controlling legal authority on the validity of a binding shareholder proposal under state corporate law before the SEC would decide one way or the other on whether the "improper subject" exclusion applies to the proposal. However, this staff position seems inconsistent with Rule 14a-8(g), which gives the company the burden of proof on whether it is entitled to exclude a shareholder proposal. According to Leonard Chazen, "under rule 14a-8(g) it is not enough for the company to raise doubts about the legality of a shareholder proposal. If the company is to exclude a proposal as an improper subject for shareholder action, the company or its counsel must prove that the proposal is legally invalid."

Thus, to the extent that issues of state law are undecided, the SEC staff has tended to stay out of that fight, declining to rule one way or the other on no-action requests, which essentially denies companies no-action relief.

**Novell:** In 1999, the SEC granted Novell's request for no-action relief to omit from its proxy materials a binding proposal on its poison pill. The SEC's decision in the no-action letter appears to rely on Novell's opinion (not the Delaware Chancery Court's) that such a proposal violates Delaware corporate law.

Because the issue of whether or not shareholder-adopted bylaws on poison pills are valid under Delaware corporate law is still 'unsettled,' the SEC's decision in the Novell no-action letter raises the question of whether the SEC has moved away from the PLM International letter.

Novell, a Delaware corporation, was faced with a binding shareholder proposal from Martin Glotzer that sought to amend the company's bylaws to (i) require the company to redeem its existing shareholder rights plan; (ii) prevent the company from adopting a shareholder rights plan unless such plan has been approved by a majority of outstanding shares of common stock; and (iii) prevent the amendment, modification or repeal of the proposed bylaw unless approved by a majority of outstanding shares of common stock.

In its request for no-action, Novell argued that the binding proposal could be omitted under Rule 14a-8(i)(1) because it violated corporate law in Delaware, where Novell is incorporated. Supported by an opinion of its Delaware counsel, Morris, Nichols, Arsht & Tunnell, Novell offered three reasons why the binding proposal violated Delaware law. Novell first argued that section 141(a) of Delaware corporate law gives the board of directors the exclusive authority to manage the company and this authority cannot be delegated to stockholders. Section 141(a) says "the business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." According to Novell, issues concerning the adoption, redemption, amendment and termination of shareholder rights plans are "clearly within the purview of the board under section 141(a)" and cannot be circumvented by a bylaw.

Novell's second argument was that the adoption, use or redemption of a rights plan is within the exclusive province of a board of directors. In support of this argument, Novell relied on the *Quickturn* decision. In *Quickturn*, the Delaware Supreme Court invalidated a poison pill under which directors were prohibited from redeeming the pill to facilitate a transaction with a person who supported the election of a new board for a period of six months (i.e., a delayed redemption provision). In making its decision, the court said restrictions on a board's power to exercise its discretion with respect to a rights plan would deprive the board of its statutory authority to manage the corporation. Since the delayed redemption provision would tie a newly elected board's hands for six months, it "tends to limit in a substantial way the freedom of [newly elected] directors' decisions on matters of management policy," said the court.

According to Novell, Glotzer's binding shareholder proposal sought to "limit the board more drastically than the provision invalidated in *Quickturn*." That is, the *Quickturn* provision only imposed a temporary restriction on the board's ability to redeem a rights plan while the shareholder proposal faced by Novell would require the termination of the company's current rights plan as well as prohibit a board from adopting a future rights plan without shareholder approval.

However, the *Quickturn* decision did not specifically address the issue of whether or not shareholders may adopt bylaws relating to shareholder rights plans. Rather, it dealt with the authority of an incumbent board to limit the power of a future board without shareholder approval, while the binding bylaw debate concerns the ability of shareholders, through the use of bylaws adopted by shareholders, to limit a board's power. In any case, Novell's argument that the adoption, use or redemption of a poison pill are exclusively within the province of a board of directors and may not be limited by a shareholder adopted bylaw has not yet been decided by the Delaware courts.

Novell's third argument was that the binding shareholder proposal violates Delaware law because it purports to require the expenditure of corporate funds. However, Cornish F. Hitchcock, an attorney for the LongView Collective Investment Fund, points out that in the past when the SEC's Division of Corporation Finance has considered this cost defense in the context of poison pill proposals, the division has refused to grant no-action relief. In addition, many shareholder resolutions—in fact most—would require the expenditure of some money. Hitchcock's statement appears in a letter to the SEC regarding a binding poison pill proposal that LongView submitted to Target (formerly Dayton Hudson). Target argued that it should be granted no-action relief from the proposal based on the precedent set by the SEC in its Novell decision.

In granting no-action relief to Novell, the SEC did not indicate which of the three arguments convinced it to grant no-action relief. Rather, the letter simply says: "there appears to be some basis for your view that Novell may exclude the proposal under rule 14a-8(i)(1)." However, the letter does say: "we note that in the opinion of your Delaware counsel, Morris, Nichols, Arsat & Tunnell, the implementation of the proposal would be improper subject for shareholder action under Delaware law."

### **Voting support of poison pill redemption proposals**

Voting support remains high. (See Figure 2.) A big jump in voting support occurred in 1994, when the average support level for these resolutions was 53.7 percent, almost a 10 point increase from the year before.

The average vote on shareholder proposals in 2002 for companies in IRRC's core research universe was 60.2 percent, up from 57 percent in 2001. The average vote on shareholder proposals in 2001 for companies in IRRC's core research universe is slightly lower compared with 57.5 percent in 2000, and 61.9 percent in 1999. Average voting support was 57.4 percent in 1998, 54.9 percent in 1997 and 53.4 percent in 1996. Including the GRC International proposal, the average for 1998 is 58.0 percent. GRC International was not included in IRRC's core domestic research universe for 1998.

#### **Year by year, support at companies targeted for repeat proposals has tended to increase:**

- In 2002, shareholders voted on resolutions at 19 companies where they also had submitted proposals in 2001. Support for the resolutions increased at Airborne, Delphi, EDS, General Motors and Northwest Airlines.
- 
- In 2001, shareholders voted on resolutions at 11 companies where they also had submitted proposals in 2000. Support for the resolutions increased at Anheuser-Busch, Burlington Northern SantaFe, Southwest Airlines, and Standard Motor Products.
- In 2000, shareholders voted on resolutions at four companies (Aspen Technology, Great Lakes Chemical, Anheuser-Busch and Quaker Oats) where they also had submitted proposals in 1999. Support for the resolutions increased at Anheuser-Busch and Quaker Oats.
- In 1999, shareholders voted on poison pill resolutions at three companies (Disney, J.C. Penney and Quaker Oats) where they also had submitted proposals in either 1998, 1997 or 1996. Support for the resolutions increased at J.C. Penney and Quaker Oats and decreased at Disney. The vote at Disney may have been

lower because the company announced before the 1999 annual meeting that it would let the pill expire in 1999.

- In 1998, shareholders voted on resolutions at seven companies where they also had submitted proposals in either 1996 or 1997. The average vote at these companies was 56.9 percent in 1998, up from 53.1 percent in the prior year.
- In 1997, seven resolutions were repeat proposals from one of the prior two years. Votes were up at six companies and down at one. On average, voting support for the resolutions at the seven companies increased to 56.9 percent in 1997, up from 50.6 percent in the prior years.

## **Performance and ownership**

One reason for the high support for proposals to redeem poison pills is that proponents tend to target poor performers, reasoning that pills are particularly suspect as entrenchment tools at companies that have not offered solid returns to investors. Most companies where shareholders voted on the issue in 2002 underperformed the S&P 500. (See Table 2.)

## **Majority votes**

Institutional ownership appears to be an important factor in predicting vote outcomes because much of institutional voting is guideline-driven, and many institutions support poison pill redemption resolutions regardless of performance history.

Surprisingly, however, the lowest vote on a shareholder resolution to redeem a poison pill for a second year in a row was 31.9 percent at Standard Motor Products, where institutional ownership is 50 percent and D&O ownership is 44 percent.

Anti-pill shareholder proposals, as one of the most successful type of shareholder resolution, account for a large proportion of resolutions that receive majority votes. IRRRC tracked 50 poison pill proposals in 2002 that came to a vote with an average vote cast in favor of 60.2 percent. Thirty-six of the 50 proposals, or 72 percent, received majority votes and passed.

Excluding proxy contests and proposals supported by management, IRRRC tracked 23 poison pill proposals in 2001 that came to a vote with an average vote cast in favor of 57 percent. Seventeen of the 23 proposals, or 74 percent, received majority votes and passed.

IRRC tracked 26 poison pill proposals in 2000 that came to a vote with an average vote cast in favor of 57.5 percent. Twenty of the 26 proposals received a majority of votes cast, while 17 of these were considered "passed" based on company voting requirements.

IRRC tracked 27 poison pill proposals in 1999 that came to a vote with an average vote cast in favor of 61.9 percent. Twenty-two of the 27 proposals received a majority of votes cast, while 18 were considered "passed" due to company voting requirements.

IRRC tracked 10 resolutions on pills that won majority votes in 1998, nine of these were deemed to have passed. In addition, IRRRC tracked 15 resolutions on pills that won majority votes in 1997, 13 of which passed.

Some companies took action in 2001 when pill proposals received a large amount of shareholder support. Pitney Bowes added a TIDE provision to its pill. Navistar agreed to redeem its pill. Following a majority vote on a pill proposal at its 2001 annual meeting, McDermott International adopted a new five-year pill that replaced a previous pill that expired in May 2001. While this appears to go against the shareholders' mandate, McDermott's new pill had a sunset provision that made the pill subject to shareholder approval at the company's May 2002 annual meeting. The pill was approved with 60.9 percent of shares voting in favor.

Georgia-Pacific, in October 1999, adopted a TIDE provision and removed its "dead-hand" provision after a shareholder proposal on its pill from LongView received support from 71.7 percent of the votes cast.

Lubrizol, in August 1999, removed its "dead-hand" provision after TIAA-CREF's proposal received support from a majority of votes cast, and J.C. Penney adopted a TIDE provision prior to the vote on a shareholder resolution regarding its pill at its 1999 annual meeting (the proposal subsequently received support from 57 percent of the votes cast).

Columbia/HCA—under intense pressure from institutional investors following a crisis in the spring of 1997—redeemed its pill. Fleming redeemed its pill in the hope of fending off a binding proposal to prohibit pills without shareholder approval.

Bausch & Lomb announced in its 1997 annual report that after consideration was given to a 1997 shareholder vote on its pill, the board decided to let the pill expire by its terms in July 1998. Mallinckrodt agreed late in 1998 to either let its pill expire or put it to a shareholder vote. (Mallinckrodt faced a binding bylaw amendment proposal in 1998.)

In 1998, SuperValu agreed to let its original poison pill expire on April 12, 1999, as part of a negotiated settlement with the Amalgamated Bank of New York's LongView Collective Investment Fund. The fund agreed to withdraw a shareholder proposal on the company's poison pill that was framed in the form of a binding bylaw amendment. LongView had submitted the binding poison pill bylaw amendment to SuperValu after the company failed to act on nonbinding proposals submitted by the fund that won majority votes in 1996 and 1997.

In reaching the agreement in 1998, LongView did not obtain any company commitment to put future pills to shareholder votes, opening the door to allow the company to adopt the new poison pill without shareholder approval. At the time, the company said that it would not adopt another pill unless a committee of independent directors approved it. In reaching the decision, according to the agreement, the committee would exercise its "good faith business judgment that the new rights plan is necessary" to give the board negotiating authority to realize full value for all shareholders. In addition to considering the interests of the shareholders, the committee would consider "whether any possible takeover or acquisition would change materially SuperValu's relationship with suppliers or customers or the communities in which it operates."

SuperValu joined the group of companies with TIDE poison pills when it announced April 14, 2000 that it had adopted a new shareholder rights plan with the three-year independent director evaluation provision. More interesting, however, is the fact that the board's decision to adopt the new poison pill came almost a year to the day from when SuperValu's previous pill expired.

Reebok International renewed its poison pill for 10 years despite the fact that a shareholder proposal asking the company to redeem its pill or subject it to a shareholder vote was approved by 53 percent of the votes cast at Reebok's May 2, 2000 annual meeting. The LongView Collective Investment Fund submitted the poison pill proposal to the company. "We're disappointed the company has decided to proceed in renewing the pill despite the shareholder position," said Cornish Hitchcock of LongView. Originally, LongView had submitted the proposal as a binding resolution. Reebok had appealed to the SEC for no-action relief to omit the proposal from its proxy statement, but withdrew this request after LongView agreed to change the proposal from a binding to a non-binding resolution. The recently renewed pill has a new trigger of 15 percent of outstanding shares, up from 10 percent. The pill, which is set to expire June 14, 2010, also includes a TIDE provision.

## **VI. ECONOMIC IMPACT OF POISON PILLS**

When the anti-poison pill shareholder campaign began in 1987, there was only one major study widely available to shareholders that measured the economic effects of poison pills: *The Effects of Poison Pills on the Wealth of Target Shareholders* by SEC Chief Economist Gregg Jarrell and Senior Economist Michael Ryngaert. The October 1986 study found that, on average, the adoption of a poison pill caused a drop in stock price, particularly for companies that were the subject of takeover speculation. This economic evidence was a principal reason for the strong shareholder antipathy to poison pills and the strong shareholder support for shareholder resolutions to redeem them or submit them for shareholder approval.

Studies since then have been mixed, but evidence is increasingly strong that in general, companies with pills receive higher premiums in takeover situations than do those that do not. Evidence on the question investigated by the SEC's Jarrell in 1986—the generalized impact of pill adoption on share price performance—is less conclusive. This question is more difficult, in part because it is hard to separate out effects of pill adoptions per se with other "noise" surrounding such adoptions, including the fact that a pill

adoption can be taken as a signal that a company sees itself a potential takeover target. The latter factor could lead to an increase in stock price, even though the pill adoption itself does serve to discourage any such bid.

Some observers downplay the importance of the various studies, saying that they provide generalized descriptions but that specific companies use pills differently—sometimes for management entrenchment. We can recognize entrenchment when we see it, say some governance advocates, and shareholder rights plans—not approved by the shareholders they are supposed to protect—can play an important role in such entrenchment. Pill advocates counter that shareholders have recourse in the courts, which can disarm pills used for entrenchment purposes. Most companies targeted for anti-pill shareholder resolutions have poor performance records in terms of returns to shareholders. Moreover, say some critics, the overriding issue is the right of shareholders to decide for themselves what protections they want. Management should make the case for adopting a pill, they say. Among the few instances when boards have sought shareholder approval for pills, they generally have won support fairly easily.

Recent studies include a 2001 study by researchers at Harvard Business School and the University of Pennsylvania's Wharton School who created a corporate governance index (using IRRC data) for 1,500 companies and studied the relationship between the index (which, among other things, considered whether the company had a poison pill in place) and company performance from 1990-1999. The study, entitled, *Corporate Governance and Equity Prices* by professor Paul Gompers and Joy Ishii of Harvard's economics department and Andrew Metrick of the department of finance of Pennsylvania's Wharton School, found "firms with stronger shareholder rights had higher firm value, higher profits, higher sales growth, lower capital expenditures and made fewer corporate acquisitions."

In 2002, Martin Lipton – the founder of the poison pill – reiterated his support for poison pills and their value to shareholders in *Pills, Polls, and Professors Redux*, 69 U. Chi. L. Rev. 1037 (2002). Lipton notes that 2002 marks the twentieth anniversary of the publication of his memorandum recommending that companies adopt the poison pill in order to deal with the takeover abuses that arose in the 1970s and had become prevalent by the end of the decade. "I have never been able to understand the persistent refusal of those academic who would hang a 'for sale' sign on public corporations to recognize: (i) that there are very significant costs to corporations in being managed as if they are continuously for sale; and (ii) that there is simply no evidence at all that the damage, if any, that the anti-pill academics attribute to the pill is greater than those costs" states Lipton.

### **Poison pill effectiveness**

Most 1990s-style bidders have proven to be more or less immune to run-of-the-mill stonewalling efforts. As a result, directors often have opted to find a "white knight" or give in to the premium offered, rather than continue to oppose hostile offers. Finding a white knight, however, means relinquishing corporate control.

Many companies have simply relented to offers of high premiums from hostile bidders—IBM's takeover of Lotus Development and Johnson & Johnson's merger with Cordis, for example.

In several instances, hostile bidders were able to undo friendly deals. Other firms, such as Puritan-Bennett, have fended off hostile tender offers, but still succumbed to takeovers within months of the failed bid.

Corporate lawyers, who stock takeover weapon stores, say such "surrender" is not necessary. Panelists at the 15th Annual Institute on Acquisitions and Takeovers Conference, for example, argued that companies can "just say 'no'" to a takeover offer. Corporate lawyers love to point to recent court decisions in Delaware (Unitrin and Wallace) and elsewhere (WLR Foods) that upheld "just say no" defensive postures. But as Skadden, Arps, Slate, Meagher & Flom's Blaine V. Fogg noted, "If you're gonna say no, you'd better damn well have a way to stop (the bidder)." While a "just say no" stance still works in theory, in practice it is feasible only in exceptional cases where institutional ownership is extremely low and board loyalty to the incumbent management is extremely high.

Some long-time supporters of the defenses claim that they are working as designed. Pills and state laws, they say, were designed to allow boards more time to negotiate with bidders and to eliminate "coercive," two-tier offers.

In reality, however, the 1980s defenses were often used as delay tactics. Since many bids in the 1980s were heavily financed, time was of the essence. If a target company could tie up a deal, in court or otherwise, it

could usually kill it. But such delay tactics are less effective when the bidder is willing and able to wage a war of attrition.

It is no coincidence that many recent hostile offers have lasted six months or more and have involved proxy contests and legal challenges. Instead of surprise, take-it-or-leave-it tender offers, bidders often go to boards first with their bids—giving them a so-called “bear hug”—in hopes of getting the directors to embrace the bid and redeem the defenses.

If talks break down, bidders often respond by making their bids public and getting shareholder support. This approach is often successful in these days of heightened shareholder activism.

As a result, shareholders’ emotions remain mixed on pills. Given the large number of hostile bids, the argument that pills and state takeover laws “chill” premium offers may have lost its impact with many investors. In many instances, the defenses have allowed boards to obtain higher premiums. But in at least some other cases, shareholders lost out on big premiums because of the company’s “just say no” positions.

In the case of Hilton Hotel’s 1997 bid to acquire ITT, a poison pill played a crucial role in fending off Hilton. During that time, ITT tried a number of maneuvers to stay independent, including some that outraged major holders. In the end, ITT lost in court on its effort to avoid a shareholders’ meeting, and it sold the company. But the ultimate buyer, Starwood Lodging, paid far more than Hilton’s early offers, and significantly more than Hilton’s final offer, benefiting ITT shareholders.

Two major court cases discussed in this report concern companies that have done well for shareholders in fending off takeover bids. In making its \$15 a share offer for Healthdyne, Invacare expressed confidence that no higher bid was likely to emerge. In fact, Healthdyne ultimately was acquired for \$24 a share by Respironics. Wallace Computer stayed independent following Moore’s bid for the company, but Wallace’s share price performance improved substantially, and some observers argue that shareholders strongly benefited because Wallace was able to implement its business plan, and was not taken over.

## **Pills and board independence**

An interesting strand in some recent studies is the interplay between board independence and the value of pills and other takeover defenses in winning higher premiums. Companies with independent boards receive higher initial tender offer premiums—and higher final takeover premiums—than do companies with non-independent boards, concludes a 1996 study in the *Journal of Financial Economics* by James F. Cotter of the University of Iowa, Anil Shivdasani of Michigan State University and Marc Zenner of the University of North Carolina at Chapel Hill. (*JFE* 42, 1996.) “Some people have looked at outside directors and not seen any results or relationships,” Cotter told IRRC. But in tender offers, he added, “outside directors can make a significant difference.”

Shareholders in target companies achieve gains that are “about 20 percentage points greater when the board is independent,” say Cotter, Shivdasani and Zenner, “suggesting that independent outside directors perform a statistically and economically significant value-enhancing role during tender offers.” The authors say that their research, along with other recent work, indicates that “when the board is independent, takeover resistance and poison pills are likely to be used to enhance shareholder returns, rather than to entrench target managers.” The study looked at 169 tender offers in the period 1989 through 1992.

Independent boards and non-independent boards are equally likely to resist an offer, the study finds, but shareholders of target companies with independent boards receive higher upward revisions of initial offers than do targets without independent boards. The results “suggest that resistance by independent boards benefits shareholder wealth more than resistance by non-independent boards,” says the study.

A 1991 study comparing characteristics of boards that adopted pills, by Paul Mallette of Colorado State University and Karen L. Fowler of the University of Northern Colorado, reached nearly identical conclusions. Mallette and Fowler looked at 673 firms and found that the following factors influenced the board to adopt a shareholder rights plan:

- The proportion of independent directors on the board has little to do with the probability that the firm would adopt a poison pill.

- When the positions of CEO and chairman of the board are filled by two persons, the probability of adoption of a poison pill decreases.
- Firms with relatively high levels of institutional holdings are more likely to adopt poison pills.
- Smaller companies are more likely to seek the protection of poison pills.
- The probability of a pill increases when director tenure is high and CEO tenure is low.
- High levels of ownership by directors discourage the adoption of pills.
- Neither returns-on-equity nor levels of debt are significant predictors of poison pill protection.

A 1992 study published in the *Journal of Financial Economics* in 1994 examined market reactions to the adoption of poison pills and its relationship to the composition of the board. (JFE 35, 1994.) The study by James A. Brickley of the University of Rochester, Jeffrey L. Coles of Arizona State University and Rory L. Terry of Oklahoma State University, found that the average stock-market reaction to announcements of poison pill adoptions is positive when the board has a majority of outside directors and negative when it does not. They also found that the percentage of outsiders on the board raised the likelihood of an auction for the target company in the event of a contest for control. Thus, the authors concluded that “outside directors serve the interests of shareholders.”

### **Impact on premiums – other studies**

A number of studies, including two published in 1997, provide strong evidence that, in general, companies with poison pills receive higher takeover premiums. It is less clear that the studies establish causality, and there can be debate about the effect of pills in determining the base share price from which premiums are measured.

A study by Professor G. William Schwert from the University of Rochester suggests that anti-takeover provisions, like poison pills, merely increase the bargaining position of target companies should a takeover proposal be offered. The study entitled “Hostility in Takeovers: In the Eyes of the Beholder,” published in December 2000 in the *Journal of Finance* examines whether hostile takeovers can be distinguished from friendly takeovers, empirically, based on accounting and stock performance data. (*Journal of Finance*, Vol. LV, No. 6) According to the study, empirical tests demonstrate that most transactions described as “hostile” in the media are not distinguishable from friendly deals in purely economic terms, except that hostile deals involve publicity as part of the bargaining process. The study analyzes 2,346 takeover contests for exchange listed target firms from 1975 to 1996 to see whether there are any identifiable differences between offers that are characterized as hostile and those that are not. The study found that there is “no reliable association between poison pills and takeover premiums.”

**Georgeson:** One of the 1997 studies was issued by proxy solicitor Georgeson. It found that companies with poison pills received \$13 billion in additional takeover premiums during the five-year period from 1992-1996.

Jamil Aboumeri of Georgeson studied 319 takeover transactions (mergers, acquisitions, tender offers and acquisitions of majority interest) completed in the five-year period ending Dec. 31, 1996, with deal size greater than \$250 million. Aboumeri found that premiums paid for companies with poison pills were on average 8 percentage points higher than premiums for non-pill companies.

The Georgeson study found that large cap companies (with capitalization more than \$1 billion) with pills received a premium of 31.25 percent, compared with 25.30 percent for non-pill large-cap companies. The gap was greater in companies with less than \$1 billion in capitalization; those with a pill received a 40.96 percent premium, while those without won premiums averaging 30.56 percent.

Georgeson ran regression analyses controlling for market capitalization, variance in price-to-book ratios and for whether the initial bids were hostile or friendly. Georgeson says that after controlling for these factors, “we still found that companies with pills received significantly higher premiums than those without.”

The study also suggests a takeover bid was as likely to be completed when a target company had a pill as when it lacked the defense. Georgeson looked at 39 takeover bids in 1992-1996 that were withdrawn without the target being acquired by another bidder. The proportion of companies in this group that had pills was about the same as that for companies where acquisitions were accomplished. Georgeson says its regression analysis found that deals actually were more likely to go through if the target company had a pill.

Georgeson says that in the period, 19 hostile bids were successful and 25 were defeated, with the target remaining independent. The “defeat rate” actually was higher when the target firm had no pill.

Finally, Georgeson says that companies with pills in the S&P 500 and the S&P MidCap index of 400 companies exhibited about the same takeover rate as those without pills.

The Georgeson study leaves some points unclear. The study made no attempt to control for share ownership—more companies with large insider ownership lack pills, because they are not necessary—or for other takeover defenses. Additionally, a major factor is the susceptibility and attractiveness of a given company to takeover bids. Managers of companies in sleepy industries, or those that otherwise may not be attractive takeover targets, may perceive less need for a pill. This could affect comparisons of companies with pills and those that opt out of the formidable defense.

Arguing that shareholders of companies without pills gave up \$14.5 billion in potential premiums during the period studied, Georgeson says “it is surprising that significant numbers of shares continue to be voted in support of the rescission of poison pills. While pills may raise some governance concerns because they deprive shareholders of voting rights, our findings support the notion that poison pills are a mechanism that contributes to the goal of maximizing shareholder value.”

In 1988, Georgeson was among the first off the mark in attempting to debunk the anti-pill findings of Jarrell’s 1986 study for the SEC. Like the 1997 report, Georgeson examined firms that had been taken over and concluded that those with poison pills brought higher premiums for shareholders than those that did not have pills.

This sparked a number of other studies and critiques: a second Georgeson study; two studies refuting the Georgeson studies, one by the United Shareholders Association (USA) and one by Analysis Group, a consulting firm; a study affirming a Georgeson study, by Prof. Donald A. Margotta of Northeastern University; Ryngaert’s expansion and update of the Jarrell-Ryngaert study; and another study by Paul H. Malatesta of the University of Washington, Seattle, and Ralph A. Walkling of Ohio State University, basically agreeing with Ryngaert.

All of the studies added some relevant information, although some observers said their view of the studies depended in part on their view of those producing them. Some of the sources were seen as promoting client interests (Georgeson represents corporate clients, for instance, while USA was a shareholder advocacy group). Some observers also labeled the academics—Jarrell and Ryngaert as “free market,” for instance, and Margotta as “pro-business.” Some poison pill supporters sought to cast doubt on the original SEC study, citing a 1989 *Washington Post* article quoting Jarrell as saying he tailored his studies to support the Reagan administration’s hands-off position on takeovers.

**J.P. Morgan:** A 1997 update to a 1995 study conducted by J.P. Morgan Securities found similar results on takeover premiums to those reported by Georgeson. The 1995 study showed that the average premium paid for firms with a pill was 15.9 percent higher than for firms without pills. Companies with pills received an average premium of 51.4 percent and companies without pills received an average premium of 35.5 percent. The updated study showed a smaller difference of 9.6 percent, as companies with pills received an average premium of 34.6 percent and companies without pills received an average premium of 25.0 percent.

Although the updated study said it is difficult to “pinpoint definitive reasons” for the difference, it speculated that the increased premiums were due to the fact that “the presence of a poison pill signals to potential acquirers that the company is prepared to resist an unsolicited and/or inadequate offer.”

The updated study reached the same conclusion as the original study: that acquisition premiums were greater for firms with poison pills regardless of whether the takeover offer was hostile or friendly, regardless of the size of the transaction, and regardless of whether the acquisition would be paid for with stock, cash or a combination of both. In addition, the takeover premium for companies with pills was higher for each year from 1993-1997, the most recent study found.

J.P. Morgan analyzed 300 transactions in the United States from 1993 through June 1997, including all transactions over \$500 million in which a majority interest was purchased. Premium values were based on the final offering price, as compared to the stock price five days prior to the initial offer.

In addition to analyzing takeover premiums, information was gathered regarding the differences in the features of the pills adopted between 1985-1993 and those adopted between 1994-1997. The typical pill put in place before 1994 had an activation level of 20 percent, while pills established since 1994 generally have had an activation level of 15 percent.

Pills adopted since 1995 have had on average, a shorter life than pills adopted earlier. Of the 718 pills in the study adopted from 1985-1993, two have had a duration of less than five years, 142 had a duration from five to nine years, 569 had a duration of 10 years and five have had a duration of more than 10 years. Of the 937 pills in the study enacted between 1994 and 1997, a total of 71 have been for a duration of less than five years, 91 have been for five to nine years, 749 have been for 10 years and 26 have been for longer than 10 years.

### **Debate on general impact of pill adoption**

Debate on the general impact of pills is fueled by contradictory findings from numerous studies. The 1986 study by the SEC's Office of the Chief Economist (Jarrell and Ryngaert), *The Effects of Poison Pills on the Wealth of Target Shareholders*, covered 245 firms that adopted poison pills, measuring stock price changes over a two-day period surrounding the adoption. It found that, on average, the adoption of a pill resulted in a 1.7 percent drop in stock price for 37 firms subject to takeover speculation. For firms actually involved in a takeover fight, the presence of a pill also enabled them to kill the takeover attempts more often than not, resulting in a much larger price decline down the line. For those not involved in takeover speculation, the stock price decline was 0.66 percent. The authors attributed the drops in stock price to the market's concern that, with a pill, incumbent managers could "block valuable takeovers and entrench themselves in office using this powerful defense, essentially driving the probability of a takeover premium to zero."

The SEC study found that the loss of shareholder wealth at the 14 companies that fought off a takeover bid with a poison pill was significant: Their net-of-market stock price declined an average of 17 percent over the six months following the bid. This outweighed the average 14 percent gain at 13 of the 30 firms that eventually were auctioned off (i.e., got a higher bid from the original bidder or from a competing bidder), the study found. (It also noted that not all of the higher takeover premium was attributable to the existence of a poison pill.) The combined result was that "the negative wealth effects of the bad outcomes (defeats) outweigh the positive effects of the bidding contests," Jarrell and Ryngaert concluded.

Also in 1986, however, the investment banking firm Kidder, Peabody examined stock price movements at 167 firms for 30 days before and 30 days after the adoption of a pill, and concluded that the adoption had no adverse effect on stock prices.

Analysis Group, an economic and financial consulting group specializing in business litigation, concluded in a 1988 study that firms with poison pills do not do better than those without pills, and that, in fact, "interpreted properly, these findings suggest that poison pill plans have a significant deterrent effect on takeover bids, and hence decrease shareholder wealth."

In its study, Analysis Group measured the overall performance of the firms adopting pills before the date of adoption and after; it used the same dates for the control group of non-pill companies, and annualized the rate of stock price appreciation. It found that much of the stock price gain for companies with pills actually occurred before the adoption of the pills: 45.8 percent for pill companies, 27.8 percent for the non-pill group (against a 38 percent average for the S&P 500). In the period after the adoption of a pill, the differences were statistically insignificant: 28.1 percent for pill companies, 27 percent for non-pill firms, 27.4 percent for the S&P 500.

The greater pre-adoption appreciation of the first group "does not show that poison pills are associated with higher values," Analysis Group said, attributing the run-up in stock price instead to a higher likelihood of takeover, or rumors of takeover, which resulted in these firms adopting pills.

**Ryngaert study:** Ryngaert, by then at the University of Florida, updated the 1986 SEC staff study in a paper published in the first quarter 1988 issue of the *Journal of Financial Economics*. The study, *The Effect of Poison Pill Securities on Shareholder Wealth*, covered a larger sample (380 firms that adopted pills up to the end of 1986, compared with 245 firms in the first study) and examined a larger number of factors. Basically, Ryngaert concluded that "not all pill defenses entrench management, but the most restrictive versions of the

defense have, on average, decreased shareholder wealth (and) have led to an increased incidence of defeated tender offers, which has seemingly harmed shareholders.”

In the updated study, Ryngaert differentiated among the various types of poison pills, and classified them by their impact on an acquirer’s possible actions. He found that flip-over pills, the least restrictive type, had only marginally negative effects on stock prices when a firm was not subject to takeover speculation (-1.04 percent without other, confounding events). By comparison, firms with discriminatory pills (flip-in, back-end and voting plans) experienced a -2.12 percent average return at companies subject to takeover speculation (-0.61 percent at those not subject to speculation). Thus, Ryngaert noted, “restrictive pills can have a significant price impact even when active takeover speculation is not present.”

Besides measuring the effect of a pill’s adoption on stock price, Ryngaert measured the impact of court rulings. After 15 of 18 decisions favoring management in its use of a poison pill, there were negative excess stock returns, while six of 11 decisions favoring the acquirer resulted in positive excess returns, indicating that, in addition to losses on the adoption of a pill, “judicial propensities to validate pill provisions may be damaging to shareholder wealth,” Ryngaert said. All in all, he concluded, “the capital markets do not react favorably to the availability of poison pill securities.”

Ryngaert found that “pill defenses have been employed to deflect unsolicited bids at a higher rate than has been observed historically” (resulting, on average, in “large negative price reevaluations”), as well as to defeat actual takeover offers. He examined the outcomes of control contests at firms with and without poison pills. In 105 contests between 1981 and 1986 at firms with pills, 31 percent of the firms remained independent and 52 percent got a higher bid. In a control group of firms without pills, only 16 percent remained independent and 68 percent got increased bids. The firms that remained independent experienced a 14.41 percent average net-of-market decline over the next six months, so “defeating bids does not appear to be in shareholders’ interest,” Ryngaert concluded.

Ryngaert noted that losses to shareholders from defeated bids are offset by gains at firms that receive increased bids, and that “frequently, management settles on improved takeover terms that allow shareholders to realize takeover-related gains on their holdings.” However, poison pills proved no more effective than other forms of takeover resistance in stimulating increased bids, he said. In addition, Ryngaert found, most of the pills in his study were not used to deter two-tier or partial tender offers, as pill supporters often claim. In 21 cases where a pill was adopted in response to an existing tender offer, 57 percent of the offers were for all the shares of the company, and in 27 cases where the initial offer was made either to shareholders or to management, two-thirds of the offers were to purchase all of the shares of the corporation.

Overall, Ryngaert concluded, “poison pill defenses have, in practice, only marginally altered the market for corporate control,” perhaps because of “fears about director liability, the role of judicial oversight, or the already considerable defenses available to management before the pill defense was invented.”

The Malatesta and Walkling study, *Poison Pill Securities: Stockholder Wealth, Profitability, and Ownership Structure*, was published in the same 1988 issue of the *Journal of Financial Economics*. Their conclusions were similar to Ryngaert’s: poison pills are management entrenchment devices and reduce shareholder wealth by a statistically significant amount.

**Comment-Schwert study:** A 1993 study by Robert Comment and G. William Schwert of the William E. Simon Business School at the University of Rochester, *Poison or Placebo? Evidence on the Deterrent and Wealth Effects of Modern Takeover Measures*, concludes there is no evidence that “modern takeover measures,” including pills, were an “economically significant determinant of the 1980s takeover boom.”

The authors looked at more than 669 successful takeovers of New York Stock Exchange and American Stock Exchange companies in the period 1976-91 to find the causes for the demise of the corporate control market during 1989-1990. They found that by 1991, 87 percent of all exchange-listed firms were covered by a poison pill shareholder rights plan; a control share law, such as the Indiana law upheld by the U.S. Supreme Court in 1987; or a business combination statute, such as the one adopted in Delaware in 1988.

The authors replicated earlier “event” studies of poison pills, such as those done by Ryngaert (1988) and Malatesta and Walkling (1988), with a fourfold increase in sample size. Their findings closely tracked those of the earlier studies—confirming price declines of several percent in several samples.

In the full sample of 1,164 cases, however, they found that pill adoptions had “no price effect.” (The average return in the sample was -2.40 percent, compared with Ryngaert’s -1.51 percent.)

Next, the authors examined the likelihood of companies covered by defenses receiving a takeover offer. They found “no evidence of deterrence” from poison pills. Having a poison pill at the start of a fiscal year, for example, was associated “with an added takeover likelihood of 2.1 percent per fiscal year,...the opposite of deterrence,” they said.

The authors also found little evidence that the rise of these defenses led to the downfall of the M&A market. Instead, they found that poison pills and control share statutes, but not business combination statutes, were “reliably associated” with larger premiums for “selling shareholders in successful takeovers.”

They also found that being incorporated in a state with an antitakeover law is the “single best predictor” of whether a firm has a poison pill. A control share statute increases the likelihood of having a pill by as much as 15.9 percent. A business combination statute increases the likelihood of having a pill by 30.7 percent.

Based on these findings, the authors concluded that pills “do not deter takeovers and are unlikely to have caused the demise of the 1980s market for corporate control.”

**CFOs and Poison Pills:** According to a survey of 1,600 chief financial officers conducted by Institutional Investor Magazine, which appeared in the Sept. 1999 issue, the majority of CFOs do not view poison pills negatively. In fact, 33.3 percent of the CFOs surveyed responded that poison pills are a highly appropriate corporate governance tool, while 55.6 percent said poison pills were an appropriate corporate governance tool in limited circumstances.

Among the CFOs surveyed, 71.3 percent responded that shareholder rights plans do not entrench management at shareholder expense, and 80.2 percent said poison pills do not hurt a company's stock price.

Of the 53.1 percent of CFOs surveyed whose companies have poison pills, 64.1 percent say that having a pill in place has not deterred hostile takeover attempts. Only 5 percent of the CFOs surveyed responded that poison pills deter hostile takeover attempts, while more than a third said that poison pills force a higher price.

Another interesting aspect of the survey was the fact that 63.0 percent of the CFOs surveyed felt that shareholders should decide whether or not a company implements a poison pill.

## VII. STATE LAWS GOVERNING POISON PILLS: RULINGS AND LEGISLATION

Poison pills remain the defense of choice in large part because they can be adopted without shareholder approval; and boards’ decisions to adopt them are largely shielded, under state statute or case law, from challenge by investors.

### Delaware

**Hilton Hotels:** The Delaware Chancery Court soundly rejected one of the singular attempts in recent years to attack the validity of poison pills. In a decision issued on Oct. 10, 2000, Chancellor William Chandler III dismissed an attempt to nullify Hilton Hotels’ poison pill. In granting Hilton’s motion to dismiss, Chancellor Chandler held that shareholders’ contract rights were not violated, nor were there any illegal restrictions placed on the company’s stock as a result of the pill. The ruling bolsters other companies with poison pills. (*Loventhal Account v. Hilton Hotels Corp.*, Civ. Act. No. 17803 (Del. Ch. Oct 10, 2000).

On Feb. 22, 2000, Leonard Loventhal Account, a trust that holds shares in Hilton, filed a complaint against the hotel chain claiming that the company’s poison pill illegally forced shareholders to accept rights that they did not want. Hilton adopted its poison pill in an effort to discourage takeover attempts in anticipation of acquiring Promus Hotel. In November 1999, Hilton sent out a notice to shareholders announcing the adopting of the poison pill tailored to the Promus acquisition. The rights attached automatically to Hilton shares and would go along with them if sold. Leonard Loventhal Account informed Hilton it was rejecting the rights and refused to have them listed on shares that the trust held.

In their complaint, the trust argued that shareholders’ contract rights were violated along with Delaware’s stock-transferability statutes because the poison pill rights automatically attached to Hilton shares. The

complaint had five grounds. The first four of the plaintiff's grounds raised technical challenges to Hilton's pill based upon provisions of the Delaware General Corporations Law. The fifth ground challenged a common provision, not vital to the operation of a pill, which addressed the liability of directors for decisions made in connection with the poison pill. Specifically, the plaintiff argued that: (1) the poison pill was not a valid and enforceable contract between Hilton and its shareholders; (2) the pill imposed transfer restrictions of stock in violation of state stock-transferability statutes; (3) the pill violated state law by not permitting "clean" and "unlegended" stock certificates to be issued; (4) the pill altered shareholder rights without amending the company's certificate of incorporation; and (5) the pill eliminated directors' liability for violating shareholder rights. Hilton filed a motion to dismiss arguing that Delaware law supported such poison pills.

Addressing the first four arguments one by one, the Court rejected each argument as inconsistent with a prior Delaware Supreme Court decision. The Court noted that the case provided an opportunity to reaffirm the basis principle of the *star decisis*. The star decisis doctrine holds that, once a point of law has been settled by a higher court decision or a decision of a court of the same rank, it creates a precedent "which is not afterwards to be departed from or lightly overruled or set aside." In his ruling granting Hilton's motion to dismiss, Chancellor Chandler stated, "[t]he trust's argument fundamentally misunderstands the issuance of securities in general and the operation of the rights plan in particular." Chancellor Chandler stressed that in 1985 the Delaware Supreme Court upheld the validity of poison pills in *Moran v. Household International, Inc.*, and that more than 2,300 poison pill plans were currently in effect, attesting to the continued applications of *Moran*. In *Moran*, the Court first upheld corporate directors' right to adopt poison pills. (*Moran v. Household International, Inc.*, Del Ch., 490 A.2d 1059 (1985), aff'd Del. Supr., 500 A.2d 1346 (1985).

Basing much of his opinion on *Moran*, Chancellor Chandler stated, "[t]here is simply no legal requirement that Hilton shareholders must be a party to the rights plan or formally vote to accept the rights plan to ensure the plan is enforceable...*Moran* clearly decided this issue." In addition, Chancellor Chandler held there were no illegal restrictions placed on Hilton's stock as a result of the pill and noted, "At any moment that this plaintiff wishes to sell its Hilton shares on the New York Stock Exchange, there is absolutely no evidence to suggest that it will not be able to find a buyer at the then prevailing market-determined price." Furthermore, Chancellor Chandler found that Hilton's notice on the shares was "appropriate" legend under Delaware law.

Addressing the fifth ground of the plaintiff's complaint, the court held the pill was not a bar to legal claims against Hilton's directors, the pill "affects neither the rights of Hilton shareholders in relation to the Hilton Board, nor the duties owed by members of the Hilton board to shareholders," Chancellor Chandler concluded. The court rejected the fifth ground, however, it also took the opportunity to state explicitly that directors "may not insulate themselves from liability...from decisions made concerning the Rights Plan." Moreover, the court required that the Order implementing its Opinion "include explicit language that [the pill] affects neither the rights of Hilton shareholders in relation to the Hilton Board nor the duties owed by the members of the Hilton Board to the Hilton shareholders." The plaintiffs appealed the ruling in the Delaware Supreme Court.

In 2001, the Delaware Supreme Court reaffirmed the validity of poison pills and held that Hilton Hotels had the right to unilaterally adopt a pill and require Hilton shareholders to adhere to its terms. The broadly worded decision highlights the consistency and predictability of Delaware corporate law and emphasizes the importance of precedent.

Upholding the Chancery Court decision, the Delaware Supreme Court ruled that a board's authority to adopt a poison pill was an "indisputable" and well established precedent in Delaware law, and it cited the earlier case, *Moran v. Household International*, where the Delaware court first upheld the right of corporate directors to adopt poison pills. The Delaware Supreme Court concluded "there is little doubt that *Moran*...denied objecting shareholders the right to oppose implementation [of a pill]."

***Gaylord shareholders litigation:*** A Delaware Chancery Court ruled that shareholders properly alleged an individual injury claim rather than a derivative claim when they claimed that their corporation's directors

improperly entrenched themselves by adopting a poison pill. See *In re Gaylord Container Corp. Shareholders Litigation*, Del. Ch. No. 14616, 8/10/99, 1999 WL 641908.

Accepting the plaintiffs' recitation of the facts as true, the court noted that in 1995, Gaylord Container's management, confronted by the imminent reduction in its control of the company's voting power from 74 percent to 20 percent as a result of its bankruptcy reorganization in 1992, entrenched itself by adopting a poison pill and amending its charter and bylaws. More specifically, the company eliminated shareholders' right to act by written consent, adopted a supermajority requirement for the amendment of its charter and bylaws and opted into Delaware's freeze-out takeover statute.

After the company adopted its poison pill and the amendments, various non-management shareholders sued, seeking damages and a rescission of the poison pill and amendments. The court denied the corporation's motions to dismiss the shareholders' complaint, finding that their complaint stated a claim that management's actions "constituted an unreasonable set of defensive measures adopted for an improper purpose."

Then, in its opposition to the certification of the plaintiffs as a class, the company argued that the plaintiffs had only stated derivative claims, not individual claims, thereby precluding a class action. A derivative claim is a claim made by a shareholder on behalf of the corporation. According to the court, entrenchment claims can be either derivative or individual. A claim, the court said, is individual when the shareholder alleges that the entrenching activity directly impairs some right held by a shareholder, such as the reduction of one's voting power.

The court found that the company's amendments to its charter and bylaws "markedly diminish" stockholders' voting power. Furthermore, the court said, the poison pill and the amendments increase the power that management stockholders have over the corporation, both as stockholders and directors, to the detriment of the non-management stockholders. According to the court, as a result of the amendments and of the adoption of the poison pill, the management holders could block a hostile acquirer, and under the supermajority amendment, could increase their blocking power in shareholder votes. It also said they could increase the economic value of their block of shares because of their increased power.

This increased power, the court went on, is not shared jointly with the non-management holders. Consequently, the conclusion that the management holders have increased their power at the expense of the non-management holders "cannot be reasonably questioned," the court concluded.

Thus, the chancery court ruled that when a board reduces the ability of non-management stockholders to elect a new slate of directors, consider sales proposals (the pill), and amend the bylaws and charter, the injury to the non-management stockholders is independent and distinct from any injury to the corporation (derivative action). "Indeed, whatever injury that results is to the stockholders. . . that have lost relative power, not to the corporation as an entity," said the court.

As result, the court in certifying the plaintiff class explained: "Although a Gaylord share is a Gaylord share, the reality is that [the poison pill and other entrenchment measures] affect the management holders and the non-management holders differently. [They] increase the power the management holders wield over the corporation, both as stockholders and as directors, to the detriment of the non-management holders."

However, on Jan. 26, 2000, the Delaware Chancery Court ultimately rejected the Gaylord Container shareholders' challenge to the board of director's adoption of the various takeover defenses. See *In re Gaylord Container Corp. Shareholders Litigation*, Del. Ch., Consolidated Civil Action No. 14616, 1/26/00.

Vice Chancellor Leo Strine found that the Gaylord board acted in response to a legitimate threat that the Gaylord stockholders could be prey to an inadequate tender offer, and adopted defensive measures "reasonably proportionate to that threat." Thus, Gaylord's board satisfied the two prongs of the *Unocal* test.

**Other litigation:** At Unitrin, the Delaware courts in 1995 upheld a poison pill that the board adopted in response to an unfriendly bid from American General, although they blocked Unitrin's proposed buyback of 10 million shares, which could have allowed the directors to raise their ownership stake to 28 percent and thus thwart the 75 percent supermajority vote required to sell the company. (The ruling on the buyback was reversed on appeal.). See *Unitrin v. American General*, 651 A.2d 1361 (Del. 1995).

In *Moore v. Wallace Computer Services*, 907 F.Supp 1545 (D. Del. 1995) District court applying Delaware law upheld Wallace's pill against the challenge from Moore, even though a large majority of shares were

tendered to Moore, which won a proxy fight for board seats on Wallace's board, but failed to win control because of the company's staggered election of directors.

## Delaware rulings on dead-hand pills

**Toll Brothers:** In July 1998, Vice Chancellor Jack B. Jacobs of the Delaware Chancery Court in, *Carmody v. Toll Brothers*, 723 A.2d 1180 (Del. Ch. 1998), denied a motion to dismiss a complaint against the continuing director provision of the Toll Brothers' (a Delaware corporation) poison pill. In Toll Brothers, the Delaware Court of Chancery assessed the legality of the dead-hand poison pill. In its decision the court held, in the context of a motion to dismiss, that continuing director provisions are subject to legal attack on both statutory and fiduciary grounds.

"Absent express language in the charter," said the court in making its decision, "nothing in Delaware law suggests that some directors of a public corporation may be created less equal than other directors, and certainly not by unilateral board action. Vesting the pill redemption power exclusively in the continuing directors transgresses the statutorily protected right to elect the directors who would be so empowered."

Moreover, said the court, a dead-hand provision "would jeopardize a newly elected future board's ability to achieve a business combination by depriving that board of the power to redeem the pill without obtaining the consent of the continuing directors." Company arguments that the rights plan does not on its face preclude a proxy contest, and that the dead-hand provision is tantamount to a delegation to a special committee, are without merit, said the court.

The ruling notes that poison pills were ruled valid in part because if a board refused to redeem the rights, shareholders could remove and replace the board. The complainant's arguments of shareholder disenfranchisement are valid, said the court, and reflect that "the shareholder vote has primacy in our system of corporate governance."

Finally, the dead-hand provision is an "unreasonable defensive measure," said the court, which suggested support for the claimant's view that the dead-hand provision makes a proxy contest "realistically unattainable."

However, the court's decision in Toll Brothers specifically said it did not affect dead-hand provisions of limited duration, known as slow-hand provisions. These provisions ban redemption of a pill by non-continuing directors, but only for a limited period after their election, such as 180 days.

**Quickturn Design Systems:** In a Dec. 31, 1998 decision, *Quickturn Design Systems v. Shapiro*, 721 A.2d 1281 (Del. 1998), the Delaware Supreme Court closed the loophole left open by Jacobs in *Toll Brothers*—i.e., dead-hand provisions of limited duration.

The Delaware Supreme Court rejected Quickturn Design System's appeal of the Delaware Chancery Court's decision (also by Jacobs) in *Mentor Graphics Corp. v. Quickturn Design Systems*, 728 A.2d 25 (Del. Ch. Dec. 3, 1998) and held that Quickturn's directors violated their fiduciary duty to shareholders when they added a delayed redemption provision to the company's poison pill.

Thus, there is no doubt that dead-hand poison pills that restrict directors duties, even for a relatively short period, are invalid under Delaware law. Unlike Judge Jacobs' lower court decision in *Quickturn*, which he specifically limited to the facts of that case, the Delaware Supreme Court's ruling will apply to every corporation incorporated in Delaware.

In reaching its decision, the Delaware Supreme Court agreed with Mentor Graphics' argument that the delayed redemption provision would impermissibly deprive any newly elected board of both its statutory authority to manage the corporation and its fiduciary duty.

One of the tenets upon which Delaware corporate law is based is that the board of directors has the ultimate responsibility for managing the business and affairs of the corporation. It confers upon any newly elected board of directors *full* power to manage and direct the business and affairs of a Delaware corporation. In addition, Delaware corporate law requires that any limitation on the board's authority be set out in the corporation's certificate of incorporation.

Accordingly, the Delaware Supreme Court held that a delayed redemption provision had the effect of preventing a newly elected board of directors from completely discharging its fundamental management duties to the corporation and its shareholders. In fact, even though the Delaware Supreme Court found that the delayed redemption provision limited the board's authority in only one respect—the suspension of a rights plan—it nonetheless restricted the board's power in an area of fundamental importance to shareholders, the negotiated sale of a corporation, and thus was invalid under Delaware law.

In its decision, the Delaware Supreme Court specifically stated, however, that any directors installed in a shareholder meeting by Mentor would be required to discharge their “unremitting fiduciary duty to manage the corporation for the benefit of Quickturn and its stockholders.”

(While the company seeking to acquire Quickturn—Mentor Graphics—won the court battle, it lost the war in January 1999 to a rival bid for Quickturn from Cadence Design Systems.)

### **Georgia, Pennsylvania, New York rulings**

In July 1997, Judge Clarence Cooper of the U.S. District Court for the Northern District of Georgia upheld a continuing director provision in Healthdyne's shareholder rights plan. See *Invacare Corp. v. Healthdyne Technologies*, 968 F. Supp. 1578 (N.D. Ga. 1997). The court concluded that continuing directors provisions are valid as a matter of Georgia law. Invacare sought to acquire Healthdyne, a Georgia-incorporated company.

Healthdyne's rights plan provided that the redemption or amendment of the plan must be approved by one or more continuing directors. Invacare sought to oust the board and install its own slate of directors, with the goal of winning approval of the merger and deactivating Healthdyne's poison pill.

Invacare sought to remove the continuing director provision from the rights plan. The company relied heavily in its arguments on *Bank of New York v. Irving Bank*, 528 N.Y.S.2d 482 (N.Y. Sup. Ct. 1988), a 1988 New York Supreme Court decision that invalidated a continuing director provision under New York corporate law because it restricted the power of the board of directors to manage the corporation. That is, in *Irving* the New York Supreme Court concluded that the board of directors of a New York corporation did not have the statutory authority to adopt a dead-hand provision because it would restrict the power of future boards. The court read the relevant sections of the New York corporate code as prohibiting an existing board from entering into agreements restricting the powers of future boards.

In finding for Healthdyne and its continuing director provision, Judge Cooper noted major differences between New York law and Georgia law that affected the case. In particular, he noted that New York corporate law specifically states that any restriction on a board's power to manage the business of the company is invalid unless all shareholders authorize the restriction in the company's charter. Georgia corporate law has no such provision. He also noted that certain provisions in Georgia law use the continuing director concept, providing further legitimacy for the idea.

In addition, as noted above, Judge Cooper ruled that section 14-2-624(c) of Georgia corporate law gives the board, not shareholders, the sole discretion to determine the terms and conditions of rights agreements.

Furthermore, Healthdyne's pill contained a strong continuing director provision. It provided for an absolute prohibition against a newly elected board redeeming rights without the consent of continuing directors, and if there are no continuing directors, the pill could not be redeemed.

A milder continuing director provision adopted by some companies allows non-continuing directors to redeem the rights under certain circumstances, for example, if they were elected by holders of at least two-thirds of outstanding shares, or if for some period of time no merger or other business combination is proposed. Yet another version bans redemption of the pill by non-continuing directors, but only for a limited period after their election, such as 180 days. Some attorneys suggest that these other, weaker dead-hand pills are more likely to be upheld under corporation law in other states.

In October 1998, Judge James T. Giles of the U.S. District Court in Philadelphia upheld AMP's no-redemption poison pill—generally viewed as even more extreme than a dead-hand pill—saying that Pennsylvania law allows companies to adopt pills subject to “such terms as are fixed by the board of directors.” See *AMP Inc. v. AlliedSignal*, 1998 WL 778348 (E.D. Pa. Oct. 8, 1998). The AMP no-hand provision was non-redeemable and non-amendable for approximately 14 months. The no-hand pill is more restrictive than the dead-hand provision as continuing directors can redeem the later, whereas they cannot redeem the former.

In the AMP decision the court suggested that if the no-hand provision were indefinite it would lean toward a finding of lack of good faith or self-dealing.

## **Maryland Legislation**

On June 1, 1999, the Maryland Unsolicited Takeover Act (Act) was signed into law. The Act rejects the Delaware model which subjects boards attempting to use takeover defenses to heightened scrutiny and to increased risks of personal liability. Instead, the Maryland Act appears to offer almost unqualified protection for incumbent directors and management and has been criticized by institutional investors and shareholder activists who view it as a management entrenchment device.

The Maryland Unsolicited Takeover Act contains a poison pill endorsement provision that codifies the 1989 *Realty Acquisition v. Property Trust of America*, 1989 WL 214477, *Fed. Sec. L. Rep. P 95,245 (D.Md. Oct. 27, 1989)*, decision that upheld shareholder rights plans under Maryland corporate law. The Maryland poison pill endorsement statute also contains a continuing director (slow-hand) feature.

In particular, under the new law the board of directors of a Maryland corporation may in its sole discretion determine the terms upon which rights, options, or warrants are issued, and their form and content. Such terms determined by the board may preclude or limit the exercise, transfer, or receipt of such rights, options, or warrants or invalidate or void any such rights, options, or warrants. The board of directors may also limit for a period not to exceed 180 days (slow-hand feature) the power of a future director to vote for the redemption, modification, or termination of the rights, options or warrants. (Slow-hand features in poison pills are invalid under Delaware corporate law).

## **Ohio Legislation**

On November 14, 2001, the Ohio General Assembly approved S.B. 110 by a margin of 30-0 and Governor Bob Taft signed the legislation into law on November 21 establishing the legality of “dead-hand” poison pills. The new law makes it more difficult to complete a hostile takeover of an Ohio company.

The legislation, which was sponsored by Senator Bruce Johnson (R-Columbus), gives more power to boards of directors at target companies. The need for the law, however, is unclear. According to Michael Ellis, Chairman of the Ohio State Bar Association’s Corporate Law Committee, there has not been a hostile takeover attempt of an Ohio corporation since 1996.

According to the Status Report on Legislation, the new law became effective February 20, 2002.

## **Poison Pill Endorsements:**

Outside of Delaware, directors’ decisions to stand behind poison pills are protected by statute in 28 states. By endorsing poison pills in their state codes, these states have added considerable strength to the positions of in-state companies should their pills be challenged in court.

The language of poison pill endorsement statutes varies greatly. Essentially, they all grant to boards of directors the authority to issue rights or options with conditions that prevent the holder or holders of a specified percentage of the outstanding shares from exercising those rights or options. Some endorsement statutes grant more authority to the board than others.

However, many believe that poison pills have lost their aura of invincibility in the last few years because a number of hostile bidders have succeeded by offering very large premiums. Pills have been less effective in the face of high premiums accompanied by proxy battles and increased pressure from institutional investors.

**Table 3:  
States with Poison Pill Endorsement Statutes**

Colorado	Indiana	Mississippi	Oregon	Utah
Florida	Iowa	Nevada	Pennsylvania	Virginia
Georgia	Kentucky	New Jersey	Rhode Island	Washington
Hawaii	Maryland	New York	South Dakota	Wisconsin
Idaho	Massachusetts	North Carolina	South Carolina	
Illinois	Michigan	Ohio	Tennessee	

## **VIII. PROXY VOTING GUIDELINES AND INSTITUTIONAL SHAREHOLDER VIEWS**

Supporters of pills argue that they force uninvited bidders to negotiate with the board. These negotiations, advocates say, allow time for the company to maximize value for shareholders by forcing a higher premium out of a bidder, attracting a white knight or allowing the company to pursue its own strategy for enhancing shareholder value.

But opponents contend that a poison pill deters potential bidders from ever making bids. They argue that the adoption of pills lowers share value (a view supported by some empirical studies) and deters “unfriendly” takeover offers. This is especially true, they say, in states where legislatures have endorsed the adoption of poison pills and expanded directors’ discretion to reject premium-to-market tender offers.

In addition, the adoption of pills without prior shareholder consent has been a source of friction between institutional investors and boards since the use of rights plans began. Even those large institutional investors who tend to view pills as generally benign often say the opportunity to vote on their adoption is essential.

Many institutions look at the pills of individual companies on a case-by-case basis. Key questions for them typically include:

- How restrictive is this particular poison pill?
- Are there particular circumstances at this company that warrant the protection of a pill?
- What is the life of the pill? Is a three- or five-year duration enough, rather than locking in the defense for 10 years?
- What restraints, if any, are there on the board’s use of the pill?
- Is the ownership threshold for triggering the pill so low that it might prevent a shareholder with no hostile intent, including institutional investors, from acquiring a desired block of stock?
- Does the company have other protective devices that make a poison pill unnecessary or less necessary?

### **Institutional shareholder views**

During the 2001 proxy season, IRRC conducted a survey asking institutional investors about their voting policies on a wide variety of corporate governance issues. Respondents to IRRC’s survey represented a broad range of institutional investors, including public pension funds, Taft-Hartley funds, insurance companies, corporate pension funds, investment managers, colleges, universities, foundations, church groups, bank companies, and various other institutions that did not fit any of the aforementioned categories. Percentages in the tables below are based on total responses for each individual question, not on total survey participation.

Overall, the position of institutional shareholders on pills has not changed despite the fact that academics have apparently developed a newfound admiration for pills. In IRRC’s 1993 survey of voting policies, 53 percent of respondents said they would vote against a proposal to approve a poison pill. In 2001, only 5 percent of the respondents said they would vote against a poison pill proposal. Academics and others remain divided over the economic consequences of adopting and maintaining poison pills.

As seen in Table 4, the highest levels of opposition to management pill proposals were from public pension funds and investment managers. Just under two-thirds of investment managers said they would vote against adoption of a pill. In contrast, corporate pension funds have emerged as the strongest pill proponents with 75 percent of corporate pension funds saying they support the adoption of a pill. The voting patterns for the colleges, universities and foundations has changed from nearly half looking at the issue on a case-by-case basis in 1993, to half voting against the adoption of a poison pill.

**TABLE 4: VOTING POLICIES OF APPROVING A POISON PILL**

<i>Type of Institution</i>	<b>For</b>	<b>Against</b>	<b>Case-By-Case</b>	<b>Abstain</b>
Public Pension Funds	5%	52%	43%	0%
Taft-Hartley Funds*	100%	0%	0%	0%
Insurance Companies*	0%	100%	0%	0%
Corporate Pension Funds	75%	0%	25%	0%
Investment Managers	13%	61%	26%	0%
Colleges, Universities, Foundations	30%	50%	20%	10%
Church Groups*	0%	0%	100%	0%
Bank/Trust Company*	0%	100%	0%	0%
Other*	0%	0%	100%	0%
<i>All Respondents</i>	<i>69%</i>	<i>5%</i>	<i>26%</i>	<i>0%</i>

\* Fewer than three participants in this category responded to this question.

IRRC's 1993 survey combined its analysis of shareholder proposals to *redeem* a poison pill and proposals to allow shareholders to *vote on* a poison pill. In 2001, the questions were separated, and, not surprisingly, proposals to allow shareholders to vote on the adoption of a poison pill received more support than seeking to redeem the plans. Survey respondents totaling 57 percent said they would vote for a shareholder proposal to redeem a poison pill. Seventy-two percent of survey respondents (Table 5) said they would vote for shareholder proposals asking to have a poison pill put to a vote.

**TABLE 5: VOTING POLICIES ON PUTTING ADOPTION OF PILL TO A VOTE**

<i>Type of Institution</i>	<b>For</b>	<b>Against</b>	<b>Case-By-Case</b>	<b>Abstain</b>
Public Pension Funds	86%	0%	14%	0%
Taft-Hartley Funds*	0%	100%	0%	0%
Insurance Companies*	50%	50%	0%	0%
Corporate Pension Funds	25%	75%	0%	0%
Investment Managers	71%	16%	13%	0%
Colleges, Universities, Foundations	56%	0%	33%	11%
Church Groups	100%	0%	0%	0%
Bank/Trust Companies*	100%	0%	0%	0%
Other*	100%	0%	0%	0%
<i>All Respondents</i>	<i>72%</i>	<i>13%</i>	<i>13%</i>	<i>1%</i>

\* Fewer than three participants in this category responded to this question.

As seen in Table 5, few investors approach the shareholder proposal issue on a case-by-case basis. More than four-fifths of public pension funds and nearly three-fourths of investment managers said they routinely vote for proposals asking that the company put its pill to a shareholder vote. Opposition to these proposals is being led by corporate pension plans, which, by a three-to-one margin, say they have a policy of voting against proposals to put the adoption of a pill to a shareholder vote.

## DEFINITIONS:

Poison pills may contain one or more of the following provisions:

**Trigger** - stock ownership percent required to trigger the pill

**Flip-in** - provision that allows rights holders to buy company stock at a discount

**Flip-over** - provision that allows rights holders to buy stock in the acquiring company at a discount

**Sunset provision** - provision that stipulates plan will expire in a particular year unless approved by shareholders

**Referendum feature** - allows shareholders to vote to redeem the pill at a meeting (usually called by the bidder) when a company is presented with certain types of offers

**Qualified offer** - provision that requires that the pill be inactive in the face of specific types of offers

**Back door redemption clause** - provision that gives the board of directors the opportunity to block the effectiveness of the pill following a triggering event

**Exchange option** - provision that allows the board to issue one share of common stock for each right after the trigger point has been passed

**Adverse person clause** - provision which sets an ownership level of a certain percent for triggering the pill if the board determines that the acquirer is an adverse person

**Continuing director clause** (“dead-hand” provision) – provision which allows only continuing or independent directors to redeem the pill

**Three Year Independent Director Evaluation (TIDE) feature** - requires a committee of the board composed of non-management directors to review the pill, at least every three years.

## KEY TO SHAREHOLDER PROPONENTS AND COORDINATORS

AFL-CIO	American Federation of Labor—Congress of Industrial Organizations
AFSCME	American Federation of State, County and Municipal Employees
Calpers	California Public Employees’ Retirement System
CREF	College Retirement Equities Fund
CWA	Communications Workers of America
Gilberts	John J. Gilbert and associates
IAPE	Independent Association of Publishers Employees
IBEW	International Brotherhood of Electrical Workers
ICCR	Interfaith Center on Corporate Responsibility
HERE	Hotel Employees & Restaurant Employees International Union
Laborers	Laborers’ International Union of North America
LongView Fund	LongView Collective Investment Fund
Nycers	New York City Employees’ Retirement System
OCAW	Oil, Chemical & Atomic Workers International Union
Operating Engineers	International Union of Operating Engineers
Paperworkers	United Paperworkers International Union
SEIU	Service Employees International Union

	SMWIA	Sheet Metal Workers International
	SWIB	State of Wisconsin Investment Board
	Teamsters	International Brotherhood of Teamsters
	UBCJA	Pension funds affiliated with the United Brotherhood of Carpenters and Joiners of America
	UFCW	United Food and Commercial Workers
	Unite	United Needletrades and Industrial Textile Employees
	NYS Retirement Fund	New York State Retirement Fund

**Notice:** The reproduction or transmission of Corporate Governance Service Background Reports is prohibited under copyright law. If you are not a paid subscriber to IRRC's Corporate Governance Service or Proxy Information Service, you are not entitled to receive Background Reports. To subscribe, call (202) 833-0700.