Poison Pills - How Effective Is Too Effective?

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Although its prevalence has been in decline in recent years, the traditional stockholder rights plan (the so-called “poison pill”) remains one of the most effective anti-takeover devices in a board of directors’ arsenal. The pill’s validity has long been established in Delaware. Recent opinions have even suggested affirmatively that, in certain circumstances, a board of directors should adopt a pill, underscoring the effectiveness of these devices. But the pill’s best quality is also its greatest flaw— that is, the more effectively that a particular pill operates to deter acquisitions and other concerted stockholder action, the less likely it is to survive a court’s scrutiny. In the years following the Delaware Supreme Court’s landmark Moran decision, the Delaware courts cut back on certain features that took the basic structure too far.

Because the pill is such a potent defense, and because pill challenges invariably implicate fundamental issues of corporate governance and control, cases addressing a pill’s validity have historically had an outsized influence in corporate law. The most recent addition to Delaware’s line of pill cases, Yucaipa American Alliance Fund II, L.P. v. Riggio, is no exception. Yucaipa involved a challenge to a poison pill that grandfathered an existing 30% insider stockholder and capped all other stockholders at 20%. While this fact pattern is not applicable to most companies facing a hostile takeover threat—the presence of a significant stockholder itself would generally be expected to dissuade acquirers— the Chancery Court’s decision to uphold the pill, and its observations regarding the adoption process, may still provide helpful guidance to boards considering a pill.

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