



Anti-Takeover Protections

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This memorandum summarizes the anti-takeover protections that a board of directors (the “Board”) of a publicly-traded company (the “Company”) should be aware of under Delaware law and the Company’s charter documents as it considers potential strategic transactions in the near future. In addition, it describes additional protections that the Board might consider adopting in order to deter coercive or inadequate bids for control of the Company or secure a premium in the event that the Board further considers a sale of control of the Company.

In evaluating any proposed additional anti-takeover protections, the Board should consider the standards of review applicable in the acquisition context. If the Board implements anti-takeover protections before receiving an unsolicited takeover bid, and implements appropriate measures to ensure that its actions meet the Board’s fiduciary duties of care and loyalty, the courts will apply the business judgment rule in reviewing the Board’s actions.¹ However, the implementation of any anti-takeover protections in response to an unsolicited bid will be subject to enhanced scrutiny, as set forth in *Unocal Corp. v. Mesa Petroleum Co.*² Under the *Unocal* standard, the Board must show that it had reasonable grounds for believing that a danger to corporate policy and effectiveness existed and the defensive measure chosen was proportional in relation to the threat posed.³ This standard also applies to

any deal protection device adopted by a board of directors to protect a particular transaction from competitive subsequent bidders.⁴

In general, anti-takeover protections are not designed to prevent a well-priced takeover of a company. Rather, the primary benefit of anti-takeover protections is to give a board of directors sufficient time and negotiating leverage to allow it to evaluate the offer, communicate with stockholders, and negotiate with the acquiror to preserve the company’s long-term objectives and maximize stockholder value.⁵ Adopting anti-takeover protections, however, may also have an adverse impact on a company. Implementing overly restrictive anti-takeover measures may send a signal to stockholders and prospective investors that the Company is paranoid about takeovers and adamantly opposed to changes of control. In addition, because many institutional investors in the public markets enjoy the short-term returns engendered by hostile takeovers, anti-takeover protections may have an adverse impact on the Company’s relationship with its stockholders and potential investors. For these reasons, a company may decide to adopt only a few key measures of protection.

A number of anti-takeover protections may enhance the Company’s ability to effectively evaluate or negotiate an offer by a potential acquiror of all or a substantial portion of the Company’s capital stock. Some of the more common alternatives are the following:

¹ See Tab 1 of this Information Book for a discussion of the business judgment rule.

² 493 A.2d 946 (Del. 1985).

³ See Tab 1 of this Information Book for a discussion of the *Unocal* standard.

⁴ See *Paramount Communication, Inc. v. Time Inc.*, 571 A.2d 1140, 1151 (Del. 1989).

⁵ Similarly, deal protection devices are intended to facilitate a suitor’s commitment to the combination by requiring payment of fair compensation to the extent that a more competitive offer for the company is made by a subsequent bidder.

- A stockholder rights plan;
- Statutory anti-takeover provisions;
- Defensive charter and bylaw provisions;
- Change of control contract provisions (“golden parachutes” and “tin parachutes”);
- Sale of the Company to a “white knight;”
- Issuance of stock to a “white squire;”
- Defensive litigation;
- Transfer of key assets (the “crown jewel defense”);
- Recapitalization;
- Defensive acquisitions; and
- Contractual Stand-still agreements.

1. Anti-takeover Measures

1.1 Stockholder Rights Plan

Colloquially referred to as “poison pill,” stockholder rights plans are designed to make a company unattractive to corporate raiders by giving the company’s other stockholders the right to purchase stock at an extremely dilutive price either in the company, prior to the acquisition or merger, or in the acquiror, after a successful hostile takeover. Potential acquirors will not trigger a stockholder rights plan because to do so would defeat the very purpose for which they are acquiring the shares. So long as the Company has authority to issue blank-check preferred stock without stockholder approval, a rights plan can be adopted by the Board very quickly.

In order to implement the typical poison pill or rights agreement, the Board declares a dividend of some amount of preferred share purchase rights (a “Right”) with respect to each share of the Company’s common stock outstanding as of a record date and each share of such stock issued after that date. Each Right entitles the holder to purchase some fraction of a share of a new series of preferred stock (the “Rights Plan Preferred”) at a designated price per share. The exercise price of the Rights generally is significantly higher than the market price of the Company’s common stock at the time of adoption because

it is intended to reflect the anticipated long-term value of the stock during the ten-year term of the Rights. The Rights are exercisable only upon the earlier of (1) ten business days after a person or group has acquired beneficial ownership of 20% of the Company’s outstanding shares of common stock or (2) a date designated by the Board after a person or group commences, or announces its intention to commence, a tender or exchange offer for the Company’s common stock. Any Rights held by the acquiring person or group that triggered the exercise of the Rights become null and void.

The Rights Plan Preferred generally is not redeemable and contains certain rights and preferences designed to make the Company’s capitalization structure unattractive to a potential hostile bidder. For example, each share of the Rights Plan Preferred is paid a quarterly dividend of one thousand times any cash or non-cash dividends declared or paid on shares of the Company’s common stock. Holders of the Rights Plan Preferred are entitled to one thousand votes per share, voting together with the common stock (whose holders are entitled to one vote per share). In the event of a merger or other transaction in which the Company’s outstanding common stock is exchanged for stock of the acquiror, holders of the Rights Plan Preferred are entitled to receive per share one thousand times the amount into which or for which each share of common stock is changed or exchanged. The actual “poison” in the “poison pill,” however, is found in so-called “flip-over” and “flip-in” provisions of the rights plan.

A “flip-over” provision gives the holders of the Rights the right to buy shares of the entity acquiring the Company at half of the acquiror’s current market price once the acquiror obtains control of the Company. The intended and almost inevitable effect of such a plan is to substantially dilute the acquiror’s equity.

A “flip-in” provision allows stockholders other than the acquiror to exercise a right to buy stock of the Company at half of the

Company's current market price once the acquiror has obtained a 20% or greater position in the Company's common stock. As with the "flip-over" provision, the "flip-in" provision makes an acquiror unwilling to trigger a stockholder rights plan due to the consequent dilution of its equity in the Company.

Because a potential acquiror would not want to risk triggering the stockholder rights plan, it generally would not exceed the 20% trigger or complete an attempted takeover unless the Board first redeemed Rights or amended the stockholder rights plan to permit the acquiror to make an acquisition in excess of the threshold. Further, since the acquiror would be forced to negotiate any such redemption or amendment with the Board, the Board's bargaining power in connection with the proposed acquisition is substantially increased. In cases in which a company was ultimately sold, this increased bargaining power has often resulted in higher takeover premiums for the company's stockholders.

A hostile bidder could attempt to circumvent a stockholder rights plan such as the one described above by conducting a proxy contest in either a special meeting or an annual meeting to replace the current members of the Board with directors who will act to redeem the stockholder rights plan in advance of the Rights being triggered. Two methods of forestalling such a strategy are adopting staggered terms for directors and imposing limitations on a stockholder's right to call a special meeting or act by written consent.

1.2 Statutory Anti-takeover Provisions

The Delaware General Corporation Law (the "DGCL"), and similar provisions of other state corporation laws, provides a Company with anti-takeover protection against hostile takeover bids. Section 203 of the DGCL prohibits public companies from entering into a business combination (including a merger, sale of assets or transfer of stock) with an "interested stockholder" for a period of three years after the person becomes an interested stockholder, unless certain carveouts apply. An "interested stockholder" is defined as a

person or group of persons who beneficially acquire 15% or more of the outstanding voting stock of the corporation. DGCL § 203 does not apply if the corporation's board of directors preapproves the transaction by which a stockholder becomes an interested stockholder, or if the subsequent business combination with an interested stockholder is authorized at a stockholder meeting by two-thirds of the corporation's outstanding voting stock (excluding the stock held by the interested stockholder). Further, a stockholder who acquires 85% or more of the voting stock of a corporation (excluding stock held by directors who are also officers and certain employee stock plans) in the first transaction in which it becomes an interested stockholder is not subject to the three-year waiting period for any subsequent business combination.

A Delaware corporation may amend its certificate of incorporation to "opt out" of DGCL § 203's anti-takeover protection. The amendment must be approved by the affirmative vote of a majority of the shares entitled to vote, in addition to any other vote required by law, and it must be effected before any stockholder becomes an interested stockholder. Such an amendment will not take effect until twelve months after its adoption.

The anti-takeover provisions of the DGCL provides incentive to the acquiror to negotiate with the Board in connection with a proposed acquisition.

1.3 Protective Charter Document Provisions

a) Elimination of Cumulative Voting

In an election of directors in which cumulative voting is allowed, each share of stock normally having one vote is entitled to that number of votes equal to the number of directors to be elected. A stockholder may then cast all such votes for a single candidate, or allocate them among as many candidates as the stockholder chooses. Without cumulative voting, the holders of a majority of the shares present at an annual meeting or any special meeting to elect directors would have the power to elect all the directors to be elected at that meeting, and no person could be elected

without the support of holders of a majority of the shares. Thus, elimination of cumulative voting may make a change of control more difficult.

b) Authorized Common and Blank-Check Preferred Stock

A public company should maintain a substantial reserve of authorized but unissued stock. The Company also should maintain the “blank-check” preferred stock provision in the Certificate. This provision grants the Board the power to designate and issue one or more series of preferred stock without stockholder approval. Having “blank-check” preferred stock, as well as a substantial reserve of authorized but unissued shares of stock, provides the Board with the means to take certain strong anti-takeover actions, such as issuing a substantial block of shares (for valuable consideration) to a friendly party, reorganizing the Company or making a defensive acquisition.

c) Procedures for Calling Special Stockholder Meetings

A Company may maintain the requirement that a special meeting of stockholders can only be called by the Board, Chairman of the Board, President or by one or more stockholders holding a specified percentage of outstanding shares. Allowing only a large stockholder or group of stockholders to call a special meeting has defensive value, in that it can cause an acquiror to delay submitting a stockholder proposal or taking control of the Board until the next regularly scheduled annual meeting. This delay may permit the existing Board to develop appropriate alternative strategies or negotiate with the acquiror in the interim.

d) Nominations of Directors by Stockholders

A Company may require stockholders to provide advance notice of nomination of directors to be made at stockholder meetings. This provision sets a date by which a stockholder must advise the Company of such stockholder’s intent to seek to nominate a director at a meeting and fix the contents of the notice. Failure to deliver proper notice in a timely fashion usually results in exclusion of

the nominee from stockholder consideration at the meeting.

e) Staggered Board of Directors

A Company’s Certificate of Incorporation may divide the Board into three classes, under which each Board member serves a three-year term. Since no more than one-third of the directors can be replaced in any one year, a staggered board can help provide continuity by preventing a hostile acquiror from replacing more than one class within one year. This may deter certain types of takeovers (including proxy fights and tender offers for less than all of the Company’s stock). A staggered board will not, however, deter an all-cash tender offer.

f) Removal of Directors Only for Cause – Not Currently Adopted

DGCL § 141(k) provides that, unless a company’s certificate of incorporation provides otherwise, the holders of a majority of the shares then entitled to vote at an election of directors may remove any director or the entire board of directors. A company with a staggered board of directors or cumulative voting may provide that directors can only be removed for cause. This provision can prevent an acquiror from removing one or more directors in mid-term solely to replace the director(s) with the dissident’s nominee(s).

1.4 Change of Control Employment Agreements

Change of control employment and other benefit arrangements should be reviewed to ensure that senior executives and other employees would be properly protected in the event of a business combination. Appropriately structured change of control employment agreements are both legal and proper. However, careful attention must be paid to tax, regulatory and other legal concerns. Absent a conflict of interest issue, change of control employment agreements have been found enforceable and consistent with the directors’ fiduciary duties.

a) “Golden Parachutes”

“Golden parachutes” are employment contract provisions that guarantee senior executives significant employment, cash payment or stock benefits in the event of a

change in control of the Company. These contractual provisions are intended to ensure that valued management will remain with the Company even in the face of the uncertainty and instability resulting from a hostile takeover. These provisions may require an executive to remain with the Company during the pendency of a control contest, in return for compensation in the event that the executive is dismissed, transferred or constructively terminated (e.g., subject to a demotion in position or a reduction in compensation or other benefits) following a change in control. However, the Board should note that the “golden parachute” provisions of the Internal Revenue Code and the “short-swing profits” provisions of Section 16(b) of the Securities Exchange Act of 1934 may limit the benefits of these measures. Under Rule 280G of the Internal Revenue Code, where officers, certain highly-compensated employees and (generally) one percent or more stockholders of the company receive a parachute payment equal to or in excess of three times such individual’s base compensation, an excise tax equal to twenty percent of such payment is charged to the recipient and the company is prohibited from deducting the amount of the payment in excess of the individual’s base compensation. Further, Section 16(b) of the Exchange Act prohibits a corporations’ officers, directors and ten percent shareholders from realizing “short-swing profits” from the purchase and sale or sale and purchase of any of the company’s securities within a six month period. To the extent that the parachute payment creates a short-swing profit, that amount will be disgorged from the recipient and returned to the company.

b) “Tin Parachutes”

In addition, the Board may wish to consider the adoption of “tin parachutes,” which typically cover all or a large number of the Company’s non-executive employees and provides severance pay and benefits in the event of a change of control. Following a takeover, if an employee loses his or her job or quits because his or her job is adversely affected (e.g., because of a demotion or reduction in salary or benefits), the severance benefits are triggered. Although tin parachute plans can serve to deter hostile bids if the

aggregate compensation value is significant, their primary motivation may be to help alleviate employee morale problems in the face of a potential change of control.

1.5 Active Responses to Unsolicited Tender Offers

a) Sale of the Company to a “White Knight” or Sale of Stock to a “White Squire”

In response to a hostile takeover attempt, the Company may offer its stockholders the economic alternative of selling the Company to a favored acquiror, often called a “white knight.” In addition, in an effort to protect itself against a hostile takeover bid, the Company may sell a substantial minority interest of its stock to a person or entity presumed “friendly” to the incumbent Board (often referred to as a “white squire”). A white squire would refuse to either tender its shares to the acquiror in a tender offer or vote its shares in accordance with the Board’s interests. A sale to a white squire should be carefully structured to avoid an unintended subsequent takeover bid by the former “friend.” Therefore, voting and standstill agreements may be appropriate in this context.

b) Defensive Acquisitions

The Company may desire to make defensive acquisitions to make itself unattractive to would-be acquirors or to create anti-takeover impediments. For example, the Company might borrow heavily to make an acquisition so that it becomes highly leveraged. Alternatively, the Company might acquire a business that is incompatible with the raider’s business goals or that creates antitrust concerns. Any acquisition, however, may strain the Company’s financial resources or increase debt on its balance sheet and may limit the Company’s future business and strategic flexibility.

1.6 Restructuring Defenses

The primary goal of any restructuring is to cause the value of a company’s various businesses to be better understood and to be better reflected in its stock price. A restructuring is best initiated before a company is actually faced with a bid because arranging for a friendly buyer of a

particular asset and restructuring a business to accommodate the loss of the asset are time-consuming, costly and complicated tasks that are difficult to accomplish in the midst of a takeover battle.

a) Transfer of Key Assets (the “Crown Jewel Defense”)

The Company may attempt to forestall or block a takeover bid by selling to a third party those assets (the “crown jewels”) that make the Company attractive to the potential bidder. Sale of the crown jewels may be appropriate only if the potential bidder perceives more value in the assets than does the Company itself.

b) Recapitalization

The Company may implement a recapitalization, such as the repurchase of common stock for debt or debt-like securities. The increased debt is intended to make the Company unattractive to a potential bidder, but it may also reduce the Company’s flexibility to obtain further financing for business and strategic purposes. Alternatively, the Company could pursue a stock repurchase plan that would buy back shares at or slightly above current market values. A buyback would reduce the Company’s available cash, which may be critical to any leveraged acquisition bid. The Company may also initiate a buyback in order to prevent a deterioration in the stock price and/or to reduce vulnerability to unsolicited takeover offers. One principal benefit of a buyback is that it may be quickly implemented.

c) Corporate Spin-Offs and Split-Ups

The Company may spin-off specific assets into a separate company and offer stockholders additional shares in the new company, possibly creating a higher aggregate market value and making an acquisition more expensive. Alternatively, the Company could sell off businesses that no longer fit strategic plans or split the Company into logically related units.

1.7 Defensive Litigation

The Company can institute defensive lawsuits based on state common law, federal

securities laws or other laws. Although a defensive lawsuit may not stop the actual acquisition of the Company, the benefit to litigation as a defensive technique is the delay gained, which affords the Board time to adopt other defensive measures. Litigation also allows the Company to compel disclosure and obtain information that might otherwise be difficult to obtain. Additionally, the Company can use the publicity generated by litigation to influence stockholders. You should note, however, that by instituting a lawsuit, the Company would subject itself to the same disclosure rules, delay, uncertainty, expense, and potential negative publicity it hopes to impose on the raider. Thus, litigation should generally be pursued only if substantive legal issues offer the Company a real possibility of remaining independent.