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STOCKHOLDER RIGHTS PLANS IN NEGOTIATED MERGERS: ISSUES OF DELAWARE LAW

A resurgence of activist shareholder campaigns against negotiated M & A transactions has led to new adoptions of shareholder rights plans as defensive measures. In several recent Delaware cases, the courts have examined the target board's process and the threat to the negotiated deal, and concluded that the board's action in adopting the plan met the Unocal standard. The authors review the cases.

By John F. Grossbauer and Pamela L. Millard *

Stockholder rights plans, or so-called "poison pills," are widely recognized as one of the most effective devices for defending against unfair, inadequate or coercive takeover proposals associated with unsolicited takeover bids that a board of directors may implement without stockholder approval. Despite (or perhaps because of) their effectiveness, certain institutional investors and their advisors conducted a successful campaign to discourage the use of rights plans through shareholder proposals and other methods. Accordingly, over much of the last decade, the number of companies adopting and maintaining rights plans steadily decreased, and by early 2011, only about 900 U.S. publicly traded companies had a rights plan in place – a nearly 60% drop over the last ten years.[1] Amidst a resurgence in hostile M&A activity, however, the number of U.S. public companies adopting rights plans has increased.[2] As a possible result of the increased hostile and topping-bid activity, and in light of several high-profile and successful "vote no" campaigns mounted by activist

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[1] Andrew L. Barb and Sean P. Neenan, *Poison Pills in 2011*, CONFERENCE BOARD DIRECTOR NOTES, Mar. 11, 2011, *available at* http://www.conferenceboard.org/publications/publicationdetail.cfm?publicationid=1913.

[2] Erik Krusch, *M&A: Poison Pills Popping*, WESTLAW BUSINESS CURRENTS, Dec. 3, 2010.

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stockholders against negotiated merger transactions,[3] Dell, Inc. and Compellent Technologies, Inc. recently took a novel approach to defend against potential interlopers and activist stockholders. They agreed to a requirement that Compellent adopt a rights plan within three days following execution of their definitive merger agreement providing for the acquisition of Compellent by Dell.[4]

As noted by commentators, the requirement that a target company adopt a rights plan as a condition precedent to entering into a merger agreement raises novel issues of Delaware law under the *Unocal* standard.[5] While litigation challenging the Compellent rights plan (among other matters) settled before the Delaware courts could weigh in on these issues, two recent decisions of the Delaware Court of Chancery – *Yucaipa American Alliance Fund II, L.P. v. Riggio* ("*Yucaipa*") and *Air Products & Chemicals, Inc. v. Airgas, Inc.* ("*Air Products*")[6] – provide some insight into the type of process and record required to support the adoption of a rights plan by a target board of directors. This note discusses the current state of Delaware law with regard to challenges to the adoption of rights plans, summarizes the novel approach taken in the merger agreement between Dell and Compellent, and examines the factors a Delaware court would likely consider if faced with a stockholder challenge to a rights plan adopted in the context of a negotiated merger.

VALIDITY OF RIGHTS PLANS GENERALLY

The traditional objective of a rights plan is to deter parties seeking to acquire large blocks of a corporation's stock by abusive takeover tactics and other abusive or unfair practices by making such practices unacceptably expensive to the acquiror.[7] Section 157 of the General Corporation Law of the State of Delaware (the "DGCL") authorizes the creation and issuance of rights entitling holders thereof to purchase shares of a corporation's stock of any class.[8] Section 157 further permits a corporation's board of directors to fix, in the resolutions providing for the creation of such rights, the terms and price at which such rights may be exercised.

In *Moran v. Household International, Inc.*,[9] the Delaware Supreme Court first addressed the validity of a rights plan. In *Moran*, the Court sanctioned a Delaware corporation's implementation of a rights plan containing a "flip-over" provision, which provided rights to the target's stockholders to purchase the stock of a potential acquiror at a 50% discount, and was designed to protect the corporation and its stockholders from coercive and inadequate hostile acquisitions. The court held that Section 157, as well as certain other provisions of the DGCL, provide statutory authority for a board of directors to issue rights containing a "flip-over" feature. The court further concluded that the Household board was fully informed as to the details of the plan, had adopted the plan in the good faith belief that it was necessary to protect Household from coercive acquisition techniques, and had demonstrated that the

[3] Both Dynegy, Inc. and Charles River Laboratories International, Inc. called off negotiated transactions during the second half of 2010 as a direct result of stockholder opposition. *See* Jessica Hall, *Charles River, Wuxi End Deal After Opposition*, REUTERS, July 29, 2010; s*ee also* Michael J. de la Merced, *Ending Blackstone Talks, Dynegy Seeks New Buyer*, DEALBOOK, Nov. 23, 2010.

[4] Agreement and Plan of Merger among Dell International, LLC, Dell Trinity Holdings Corp. and Compellent Technologies, Inc. dated December 12, 2010, *available at* www.sec.gov, Compellent Form 8-K, as filed with the SEC on Dec. 16, 2010 (the "Merger Agreement").

[5] *See* Charles M. Nathan, *Adoption of Poison Pill to Deter Activist Investor Opposition to Negotiated Mergers*, Feb. 2011, *available at* http://blogs.law.harvard.edu/corpgov/2011/03/04/adoption-of-poison-pill-to-deter-activist-investor-opposition-to-negotiated-mergers/.

[6] *Yucaipa*, 1 A.3d 310 (Del. Ch. 2010); *Air Products*, 16 A.3d 48 (Del. Ch. 2011).

[7] *See, e.g.*, *In re Gaylord Container Corp. S'holders Litig.*, 753 A.2d 462, 481 (Del. Ch. 2000) ("The primary purpose of a poison pill is to enable the target board of directors to prevent the acquisition of a majority of the company's stock through an inadequate and/or coercive tender offer.").

[8] DGCL § 157.

[9] 500 A.2d 1346, 1351-56 (Del. 1985) ("*Moran*").

plan was reasonable in relation to the threat posed.[10] Accordingly, the Household board satisfied the enhanced scrutiny of defensive actions required by *Unocal Corp. v. Mesa Petroleum Co.*,[11] and the adoption of the rights plan was therefore protected by the business judgment rule.[12]

ADOPTION AND MAINTENANCE OF RIGHTS PLANS

Under *Unocal*, although the business judgment rule applies to the adoption of defensive measures, the initial burden will lie with the directors to show (1) that they had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and (2) that the defensive measure chosen is "reasonable in relation to the threat posed."[13] Directors satisfy their burden under the first prong of *Unocal* by showing good faith and a reasonable investigation, and that the rights plan was adopted in response to a reasonably perceived threat to corporate policy and effectiveness, and for a proper corporate purpose.[14] Under the second aspect of *Unocal*, which itself involves a two-prong analysis, the directors must establish (1) that the defensive measure is not "coercive" or "preclusive," and (2) that such measure is otherwise within "a range of reasonable responses" to the threat posed.[15] Once directors satisfy their burden under *Unocal*, the presumptions of the business judgment rule attach to the decision to adopt a rights plan – or the decision not to redeem the rights – and the burden shifts to the party challenging the rights plan to show that the directors have breached their fiduciary duties.[16]

RECENT CASE LAW DEVELOPMENTS: *YUCAIPA AND AIR PRODUCTS*

After a period of several years in which the Delaware courts had not had the opportunity to address head on challenges to the adoption and maintenance of rights plans, the last two years saw several important rights plan decisions.[17] Two of those decisions – *Yucaipa* and *Air Products* – provide insights that may be useful in advising a target board considering the adoption of a rights plan. In particular, they suggest care must be taken in identifying the threat justifying the implementation of a rights plan, or a decision not to redeem rights following adoption.

The Activist Shareholder Threat: Yucaipa v. Riggio

In a decision addressing issues analogous to those raised by the Compellent rights plan, the Court of Chancery in *Yucaipa* held in a post-trial opinion that the decision of the board of directors of Barnes & Noble, Inc. to adopt a rights plan with a 20%, ownership threshold and a provision grandfathering Barnes & Noble's founder, but limiting his holdings to their current level above 20%, was a reasonable response to a threat posed to Barnes & Noble and its stockholders.

Unhappy with the direction of Barnes & Noble, Ronald Burkle, through certain of his investment funds ("Yucaipa"), doubled his ownership interest in Barnes & Noble to nearly 18% over a four-day period. In

[10] Although the rights plan considered by the Delaware Supreme Court in *Moran* did not contain a "flip-in" provision, pursuant to which target's stockholders receive rights to purchase the company's common stock at a 50% discount, or a provision denying certain potential acquirors the benefit of the rights, those features are now common in rights plans, and the Delaware courts have frequently upheld the validity of rights plans containing such features. *See, e.g., Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 607-08 (Del. 2010) ("*Selectica*"); *Air Products* at 55; *Yucaipa* at 361.

[11] 493 A.2d 946, 955 (Del. 1985) ("*Unocal*").

[12] *Moran* at 1356; *see also Air Products* at 92; *Yucaipa* at 331-36.

[13] *Unocal* at 955.

[14] *Air Products*, at 57; *eBay Domestic Holdings, Inc. v. Newmark*, 2010 WL 3516473, at *21 (Del. Ch. Sept. 9, 2010).

[15] *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995). A defensive mechanism is "coercive" if it is aimed at forcing upon stockholders a management-sponsored alternative to a hostile offer. *Moore Corp.*, 907 F. Supp. at 1557 n.13; *Unitrin*, 651 A.2d at 1387; *Paramount Commc'ns Inc. v. Time, Inc.*, 571 A.2d 1140, 1154-55 (Del. 1989). A defensive mechanism is "preclusive" if it deprives stockholders of the right to receive all tender offers or precludes the bidder from seeking control by means of a proxy contest or otherwise. *Moore Corp.*, 907 F. Supp. at 1562-63; *Unitrin*, 651 A.2d at 1387-88. A rights plan

footnote continued from previous column...

will be found to be preclusive if it makes a bidder's ability to wage a successful proxy contest and gain control "either mathematically impossible or realistically unattainable." *Selectica* at 601 (citations omitted); *Air Products* at 115. Chancellor Strine has suggested, however, that a rights plan will be considered preclusive unless it leaves a dissident with a "fair chance for victory" in a proxy contest – an easier standard for a plaintiff challenging a rights plan to satisfy. *Yucaipa* at 337 n.182. The Delaware Supreme Court has not adopted such a standard. *See Selectica* at 601.

[16] *Moran* at 1356; *Unocal* at 958.

[17] *See Selectica* at 607-08; *eBay Domestic Holdings,* 2010 WL 3516473 (Del. Ch. Sept. 9, 2010); *Yucaipa*; *Air Products*.

response, the Barnes & Noble board adopted a rights plan, which effectively prevented any single stockholder or group of stockholders from accumulating more than 20% of the outstanding shares of the company. The rights plan exempted Barnes & Noble founder and chairman, Leonard Riggio, and his family's existing holders (which totaled nearly 30%), but provided that any increase in the Riggio family's ownership would trigger the issuance of the rights. Yucaipa filed suit and claimed that the board had breached its fiduciary duties by adopting the rights plan and had failed to amend the plan in accordance with Burkle's request.

Applying the *Unocal* standard of review, then-Vice Chancellor (now Chancellor) Strine held that the decision of the Barnes & Noble board to adopt the rights plan was reasonable in light of the threat posed by Yucaipa, given Yucaipa's rapid accumulation of Barnes & Noble stock, meetings with investment bankers concerning potential transactions disclosed by Burkle during trial, and Yucaipa's prior investing history.[18] The court also found that the rights plan did not preclude Yucaipa's ability to mount a successful proxy contest, in part because the great publicity surrounding Burkle's negative views of Riggio's vision for Barnes & Noble ensured that stockholders would be fully informed about Burkle's view, and in part because Yucaipa's close relationship with Aletheia Research and Management, Inc., another significant investor in Barnes & Noble, meant that Burkle, together with Aletheia, controlled 36% of the shares. This essentially offset any advantage provided by Riggio's ownership.[19] Finally, the court affirmed that despite what it deemed to be a less than ideal board process, the determination by the Barnes & Noble board that Yucaipa posed a legally cognizable threat was made in good faith by an independent majority of Barnes & Noble directors, and the rights plan represented a proportionate response to that threat.[20]

The Inadequate Offer Threat: **Air Products v. Airgas**

Capping a lengthy legal battle closely watched by M&A practitioners, the Court of Chancery recently considered whether the board of directors of Airgas, Inc. should be required to redeem a rights plan in the face of a non-coercive, all-cash, all-shares tender offer from a third party acquiror, Air Products and Chemicals, Inc. Following the submission of Air Products' "best and final offer" of $70 a share, the Airgas board, newly constituted to include three directors nominated by Air Products and elected by Airgas stockholders at Airgas's 2010 annual meeting, unanimously rejected Air Products' offer as inadequate.[21] Following a detailed discussion of *Unocal's* application to rights plans over the past two decades, the court determined that the Airgas board easily satisfied the first prong of *Unocal* by undertaking an investigative process in good faith: the board was composed of a majority of outside, independent directors and relied on the advice of legal counsel, "not one, not two, but three" independent financial advisors,[22] and a detailed strategic plan was developed and carefully reviewed by the board.[23]

The court also addressed the issue of whether a structurally non-coercive tender offer that did not pose a threat of opportunity loss because there was no alternative bidder, nonetheless may constitute a "threat" warranting continued maintenance of a rights plan. While expressing his personal skepticism whether the Air Products offer could be seen as a continuing threat given the time and volume of information afforded to Airgas stockholders during the year since Air Products had made its initial offer, Chancellor Chandler held that binding Delaware Supreme Court precedent compelled the conclusion that Air Products' offer constituted a legally cognizable threat because it was at a price the Airgas board had determined in good faith was inadequate. Finding that the Airgas board could employ a poison pill as a proportionate defensive response to a "low ball" bid, the court cited *Paramount Communications, Inc. v. Time, Inc.* for the proposition that "substantive coercion," defined as "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value," has been recognized as a legally cognizable threat under *Unocal*, and noted that "inadequate price and the concept of substantive coercion are inextricably related."[24]

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[18] *Yucaipa* at 349.

[19] *Id.* Aletheia increased its stake in Barnes & Noble from 6.37% to 17.44% contemporaneous with Burkle's expression of displeasure with Barnes & Noble's management. Although the rights plan prohibited Yucaipa and Aletheia from acting in concert, Aletheia was described by the court as "an admiring and devoted fellow traveler" that could "essentially form a control bloc [with Yucaipa] without paying a control premium." *Id.* at 351.

[20] *Id.* at 344-45, 350.

[21] *Id.* at 89.

[22] *Id.* at 104.

[23] *Id.* at 103.

[24] *Id.* at 108 (citing *Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1153 (Del. 1990)).

Evaluating the second prong of *Unocal*, the court determined that Airgas's defensive measures were proportionate to the perceived threat. First, in light of the Delaware Supreme Court's holding in *Selectica* that the combination of a classified board and a poison pill is not in and of itself preclusive, the court reasoned that Airgas's defensive measures were reasonable, because Air Products had a realistic opportunity to gain control of the board at Airgas's next annual meeting, approximately eight months away.[25] Second, the court compared the reasonableness of maintaining Airgas's defensive measures in relation to the threat posed by the Air Products offer, and found that "the record demonstrate[d] that Airgas's board, composed of a majority of outside, independent directors, acting in good faith and with numerous outside advisors, concluded that Air Products' offer clearly undervalues Airgas in a sale transaction."[26] Finding that the actions of the Airgas board did not "forever" preclude Air Products or any bidder from acquiring Airgas, but merely prevented a change of control from occurring at an inadequate price, the court concluded that the response of the Airgas board was reasonable and proportionate under *Unocal*.[27]

THE COMPELLENT RIGHTS PLAN

In Section 4.2(e) of the Merger Agreement between Dell and Compellent,[28] Compellent agreed to adopt a rights plan in a form reasonably acceptable to Dell within three days of executing the Merger Agreement, and covenanted not to amend or waive any provision of the rights plan or redeem the rights provided in the plan without Dell's prior written consent. This was subject to two exceptions: (i) if Compellent's board of directors determined, in consultation with outside legal counsel, that a failure to take such action would constitute a breach by the board of directors of its fiduciary duties to the company's stockholders under applicable Delaware law (subject to Compellent's compliance with the terms of the no-shop provision contained in the Merger Agreement, and a confidentiality agreement in place between the company and Dell); or (ii) issuance of a court order or injunction requiring Compellent to take such action.

On December 15, 2010, Compellent's board of directors approved a rights plan excluding Dell from the definition of an "Acquiring Person," and establishing a 15% ownership threshold for any other Acquiring Person.[29] In a definitive proxy statement filed with the SEC by the company on December 30, 2010, Compellent disclosed that during the course of negotiations, Dell consistently required the adoption of a rights plan by the company as a condition to Dell entering into the Merger Agreement.[30] Between December 15 and December 22, 2010, several putative class action lawsuits were filed against the company and its directors alleging breaches of fiduciary duty involving, in part, the company's agreement to "preclusive deal terms," including the adoption of the rights plan.[31] On January 31, 2011, the company entered into a Memorandum of Understanding related to the consolidated class action lawsuits, the terms of which required Dell and Compellent to amend Section 4.2(e) of the Merger Agreement to eliminate the requirement that the company adopt a rights plan, and mandated that Compellent redeem the rights outstanding under the plan.[32] The company's board redeemed the outstanding rights on February 7, 2011, and the transaction closed later that month.

LESSONS FOR ADOPTION OF A RIGHTS PLAN

As M&A practitioners evaluate the pros and cons of adopting a rights plan in the context of a negotiated merger, with or without a cognizable threat that a specific activist stockholder will oppose the transaction, the following factors should be weighed carefully.

The Target Board's Process

While the nature of negotiations between a potential buyer and a target prior to the adoption by selling corporation of a rights plan is relevant to the analysis,[33] the decision to approve a rights plan ultimately rests with target's board. From *Moran* to *Air Products* and

[25] *Id.* at 114.

[26] *Id.* at 122.

[27] *Id.* at 124.

[28] *Supra* note 4.

[29] Form 8-K filed by the Company with the SEC on December 16, 2010.

[30] Form DEFM14A filed by the Company with the SEC on December 30, 2010, at 17-19.

[31] *Id.* at 7.

[32] Form 8-K filed by the Company with the SEC on January 31, 2011 at 2.

[33] From a factual standpoint, we think a Delaware court would consider whether a buyer required the adoption of a rights plan as a condition to entering into the transaction, and the negotiations between buyer and target with respect to such a condition.

Yucaipa, the process by which a board of directors determines to adopt a rights plan is critical.

Under the first prong of *Unocal*, directors must show that the board had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," a burden that can be satisfied by showing good faith and reasonable investigation.[34] Under Delaware law, "the presence of a majority of outside independent directors coupled with a showing of reliance on advice by legal and financial advisors 'constitutes a prima facie showing of good faith and reasonable investigation.'"[35] Chancellor Chandler found it "undeniable" that the Airgas board met its burden under *Unocal*, noting that the board was comprised of a majority of independent directors, including three "insurgent directors" recently nominated by Air Products, and cited favorably the board's reliance upon three independent outside financial advisors, as well as outside legal counsel.[36]

In contrast to the Airgas board, Chancellor Strine was critical of the decision of the Barnes & Noble board to include Riggio and two other directors affiliated with Riggio in substantive board discussions pertaining to the adoption of the rights plan at issue, calling the board's process "less than fully adroit" and stating that "[t]he process was not ideal."[37] The participation of the full board in the relevant discussions was particularly suspect because in the court's view, Barnes & Noble's board was comprised of "a bare majority" of independent directors.[38] Although Chancellor Strine ultimately determined that the board acted loyally and in good faith, the court's observations sound a cautionary note for practitioners to be vigilant about identifying and addressing director conflicts.

Because of the critical importance of independence, a target board engaged in deliberations pertaining to the adoption of a rights plan in the context of a negotiated merger should insure that any financial or legal advisors retained are truly independent, and, in circumstances in which a special committee was established because of management or other conflicts (such as in a leveraged buyout transaction), the committee should either recommend adoption of the plan, or, if it is authorized to do so, approve its adoption directly.

[34] *Unocal* at 955.

[35] *Selectica* at *12.

[36] *Air Products* at 104.

[37] *Yucaipa* at 345.

[38] *Id.*

Identifying the Threat

In addition to showing good faith and reasonable investigation, the burden rests on directors adopting a rights plan to demonstrate that the rights plan was adopted in response to a reasonably perceived threat to corporate policy and effectiveness, and for a proper corporate purpose.[39] In a situation such as *Yucaipa,* involving overtures by known activist stockholders, the argument that a threat to corporate policy exists could be viewed as straightforward.[40] In determining whether this threat to corporate policy and effectiveness exists in a negotiated merger, the analysis may be more nuanced. The board should consider several factors, including the nature of the target's stockholder base, the ease with which any holder may be able to amass a meaningful stake in the target, and the potential influence of arbitrageurs on the target's stockholder base. The ability of a stockholder to create leverage to attempt to exact specific benefits for the stockholder, or simply to block the transaction because the stockholder has interests in the acquiror or short-term interests in the target, would seem sufficient to justify adoption of a rights plan in many cases.

While the inadequate offer threat addressed in *Air Products* may be less acute where a floor price has arguably been set by the negotiated merger, there may be circumstances where this type of threat is more likely. Stock-for-stock mergers may present a greater potential for such a threat to materialize, because market volatility may temporarily depress the acquiror's stock price, setting the stage for an opportunistic cash bidder to enter the fray. This risk may increase where there will be an extended time between signing and closing. Again, independent financial and legal advice concerning these potential scenarios will assist the target board in making and defending a decision to adopt a rights plan. Similarly, the threat of a potential hostile bid also has been recognized consistently as an adequate threat justifying implementation of a rights plan.

Chancellor Strine recognized in *Yucaipa* the validity of a board's interest in driving a potential acquiror to engage with the board, acknowledging that "the board could reasonably conclude that Yucaipa should deal with

[39] *Air Products* at 104.

[40] *See Yucaipa* at 344-45 (stating that by the time of post-trial argument, Yucaipa "had abandoned its argument that there was never a legitimate threat to Barnes & Noble."); *see also Unocal* at 955 (finding a cognizable threat to target when the tender offer "was posed by a corporate raider with a national reputation as a 'greenmailer.'").

the board in the first instance if it wished to obtain a [control] bloc, and to pay a price to the company's investors that reflected the value of obtaining that power."[41] This rationale would seem to apply equally in the context of a negotiated merger. That is, the board legitimately may determine that it is appropriate to require any interloper to engage with the board rather than making an offer directly to stockholders. In fact, the concern that a hostile, putative, topping bidder may attempt to "end run" the board is heightened by the fact that the "competitive bid" exception in Section 203(b)(6) of the DGCL means that a hostile acquiror may launch a tender offer for a bare majority of the target without target board approval, and if successful, may consummate a second-step transaction without any need for supermajority approval under Section 203.

Other Defensive Mechanisms Available to the Board

The second prong of *Unocal* requires directors to prove that the defensive measure chosen is "reasonable in relation to the threat posed." This involves a two-part analysis that mandates a showing that (1) the rights plan was not "coercive" or "preclusive," and (2) the adoption of the rights plan was within "a range of reasonable responses" to the threat perceived.[42] A rights plan adopted pursuant to a covenant in a negotiated merger agreement would likely be evaluated in the context of structural protections reflected in the target's certificate of incorporation and bylaws, as well as the deal protection measures contained in the merger agreement.

In examining the validity of deal protection measures in combination, the Delaware courts "make a judicial determination as to whether each provision, on its own and in combination with all others, sets forth a reasonable approach for obtaining the highest value for stockholders. That is . . . to ensure that they are reasonable and do not preclude a higher bid from being successful."[43] The preclusive nature of a rights plan adopted in concert with related deal protection measures will invariably entail a fact-specific analysis, requiring the reasoned advice of a board's outside legal counsel and financial advisor. The ability of a board of directors to amend the rights plan or redeem the rights in response to a bid constituting a superior proposal would seem to be critical in this regard. Without an ability to eliminate the rights plan as a part of accepting a superior proposal, the board may be hard-pressed to defend a deal protection package including a rights plan.[44]

The Duration of the Rights Plan

Chancellor Chandler sounded a cautionary note for practitioners when, upon affirming that the Airgas board satisfied its obligations under *Unocal*, the Chancellor stated further "[i]n my personal view, Airgas's poison pill has served its legitimate purpose."[45] Noting that the rights plan at issue had been used as a defensive mechanism against Air Products for over 16 months, had given Airgas "*more time than any litigated poison pill in Delaware history*" to share its views with the company's stockholders, and had produced a $10 per share increase in Air Products' offering price, Chancellor Chandler indicated that in his view, no legitimate threat to Airgas existed, and the company's "sophisticated" stockholders had all of the information required to make an informed choice with regard to Air Products' offer.[46]

Where the stated purpose of a rights plan is to protect against threats to an acquisition transaction, a plan with a duration significantly in excess of the "drop dead" date will require careful consideration. A limited duration plan tied to the likely closing date of the merger (perhaps with some additional time to address the target's vulnerability if the transaction does not close) dovetails nicely with the current expectations of institutional investors for rights plans that have a duration of 12 months or less.

In particular, the current guidelines promulgated by Institutional Shareholders Services with respect to rights plans recommend withholding a vote for or against the re-election of all directors (except new nominees, who are considered on a case-by-case basis) if the board (1) adopts a rights plan with a term greater than 12 months, or (2) renews any existing rights plan without

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[41] *Yucaipa* at 351.

[42] *Unocal* at 955; *see also Unitrin*, 651 A.2d at 1387-88.

[43] *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487, 497 (Del. Ch. 2010) (citing *Paramount Commc'ns, Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994)). In light of *Unocal*, the court will also be required to engage in a substantive analysis of whether the adoption of the rights plan unreasonably restricts the ability of stockholders to run a proxy contest. *Unitrin*, 651 A.2d at 1387.

[44] *In re Orchid Cellmark, Inc. S'holder Lit.*, 2011 WL 1938253, at *8 (Del. Ch. May 12, 2011) (describing the layering on of one too many deal protection devices as "another instance of the straw and the poor camel's back," and stating that amalgamated deal protection devices at some point "run the risk of being deemed so burdensome and costly as to render the 'fiduciary out' illusory.").

[45] *Air Products* at 57.

[46] *Id.* (emphasis in original).

stockholder approval.[47] ISS's views regarding the appropriate duration for a rights plan adopted by a target contemporaneous with entering into a merger agreement remain unclear. However, to the extent such right plans become more prevalent, we anticipate that ISS will focus its review on the deal protection devices reflected in the merger agreement as a whole, and whether the duration of the rights plan is reasonable in light of the timing of the proposed transaction.

CONCLUSION

The Delaware Supreme Court foreshadowed in *Unocal* the evolution of rights plans observed in the merger between Dell and Compellent, noting "as the sophistication of both raiders and targets has developed, a host of other defensive measures to counter such ever-mounting threats has evolved and received judicial sanction."[48] Although the judicial response to a rights plan adopted in the context of a negotiated merger remains uncertain, recent jurisprudence from the Delaware courts suggests that target boards and their independent advisors should remain cognizant of a number of factors, including (i) the target board's process, (ii) the nature of the threat from outside parties, (iii) other defensive mechanisms available to the board, and (iv) the duration of the rights plan. ■

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[47] INSTITUTIONAL SHAREHOLDER SERVICES INC., 2011 U.S. PROXY VOTING GUIDELINES SUMMARY at 12 (Jan. 27, 2011). A commitment to put newly adopted rights plans to a stockholder vote may offset such an adverse vote recommendation by ISS. *Id.*

[48] *Unocal* at 957.