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Delaware Supreme Court Affirms Approval of 4.99% Rights Plan to Protect NOLs

The Delaware Supreme Court yesterday unanimously affirmed, yet again, that the pill remains a vital and flexible tool for protecting the corporate enterprise from hostile tender offers, market accumulations, and threats of many varieties. [*Versata Enters., Inc. v. Selectica, Inc.*, No. 193, 2010 \(Del. Oct. 4, 2010\) \(en banc\)](#). More importantly, the decision reconfirms that directors need not passively face threats; instead, boards have the power to directly combat assaults on the corporation with bold and innovative action.

The case involved the adoption, deployment, and reloading of a shareholder rights plan with a 4.99% trigger designed to protect Selectica's \$160 million of net operating loss carryforwards (NOLs). Long-time corporate rival Trilogy had rapidly accumulated a position of over 5%. Advised by experts that additional acquisitions of large blocks of stock could trigger a technical ownership change under the tax code and impair the value of Selectica's NOLs, the board adopted a shareholder rights plan to deter the creation of additional 5+% blocks and to deter current 5% holders from increasing their positions by more than 0.5%. Trilogy continued to purchase shares, intentionally triggering the new rights plan. After Trilogy refused to enter into a standstill agreement to halt its accumulation, the Selectica board deployed the exchange feature of the pill—diluting Trilogy from 6.7% to 3.3% ownership—and adopted a reloaded NOL pill to deter further potentially harmful acquisitions.

Following a full trial, Vice Chancellor Noble upheld the board's actions as a reasonable response to a threat to the corporate enterprise, as discussed in our earlier [memo](#). In affirming this decision, the Delaware Supreme Court methodically reviewed the board's conduct under the well-established *Unocal/Unitrin* standard. First, the Court concluded that the board had reasonably identified the potential impairment of the NOLs as a threat to Selectica. Noting that the directors met frequently, were well-counseled, and “acted in good faith reliance on the advice of experts,” the Court held the board had “reasonable grounds” for concluding that the “NOLs were worth preserving and that Trilogy's actions presented a serious threat of their impairment.”

Second, the Court held that the 4.99% rights plan was not preclusive. Explaining that a defensive measure cannot be preclusive unless it “render[s] a successful proxy contest realistically unattainable given the specific factual context,” the Court credited expert testimony that challengers with under 6% ownership routinely ran successful proxy contests for micro-cap companies. The Court sharply rejected Trilogy's contention that Selectica's full battery of defenses was collectively preclusive, holding that “the combination of a classified board and a Rights Plan do[es] not constitute a preclusive defense.” The Court noted that classified boards may delay takeovers (by requiring a would-be acquirer to wait through a two-year period to obtain control), and recognized the increased defensive force of a classified board combined with a low-trigger pill. Nevertheless, the Court held, “[t]he fact that a combination of defensive measures makes it more difficult for an acquirer to obtain control of a board does not make such measures realistically unattainable, i.e., preclusive.”

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Finally, the Court concluded that the board's actions fell within an appropriate range of reasonable responses to the Trilogy threat. Surveying the acrimonious history between the two companies and concluding that Trilogy was specifically targeting the NOL assets to extract leverage in its negotiations with the board, the Court held that the adoption, deployment, and reloading of the 4.99% pill was a proportionate response. Justice Holland cautioned, however, that the Court's holding "should not be construed as generally approving the reasonableness of a 4.99% trigger in the Rights Plan of a corporation with or without NOLs." Instead, directors, in consultation with their advisors, must appropriately tailor their defensive actions to meet the specific threats their companies face, including as the facts and circumstances may change over time.

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