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Delaware Court of Chancery Upholds Rights Plans as a Defense to Activism

Last week, the Delaware Court of Chancery upheld the use of a shareholder rights plan in response to an aggressive public campaign by an activist shareholder. [\*Third Point LLC v. Ruprecht, et al.\*, C.A. No. 9469-VCP \(May 2, 2014\)](#). This important decision reaffirms that Delaware directors may take appropriate action to defend against any reasonably perceived danger to corporate effectiveness, whatever the source of the threat.

Last year, several activist funds, including Third Point LLC, accumulated large stakes in Sotheby's. In October, Third Point disclosed that it had increased its stake to 9.4%. It also publicly criticized Sotheby's board and management, demanded board representation, and announced that it had "already commenced informal discussions" with potential CEO replacements. Two days later, Sotheby's board adopted a two-tiered rights plan that triggered at a 10% level for 13D filers and at 20% for "passive investors" who file on Schedule 13G. The plan exempted whole-company tender offers that treat all stockholders equally.

This February, Third Point launched a short-slate proxy contest and requested an exemption from the rights plan to allow it to buy up to 20%. The board denied the request, and Third Point sued, seeking an injunction to delay the annual meeting. Third Point argued that the board could not lawfully enforce the 10% trigger in light of the proxy contest. Third Point did not assert that the plan precluded it from winning, as both sides expected the race to be close. But it was undisputed that allowing Third Point to go to 20% could make a difference.

The Court of Chancery denied the motion for injunctive relief, and found that Third Point's claims were not likely to succeed on the merits. Vice Chancellor Donald F. Parsons, Jr. rejected the claim that the only threat boards may consider when adopting and maintaining a rights plan is a full-company takeover, and held that rights plans can be deployed in activist situations even if they may affect a tight activist-led proxy contest. Most notably, though it found the case to be close one, the Court held that Third Point's aggressive conduct had led Sotheby's to reasonably fear that Third Point might come to exercise "negative control" over the company, and that this concern justified the board's refusal to exempt Third Point from the 10% trigger. Allowing "individuals or entities . . . to exercise disproportionate control and influence over major corporate decisions" can pose a threat to corporate well-being and justify a rights plan, the Court found, "even if [those individuals or entities] do not have an explicit veto power."

In so holding, the Court of Chancery reaffirmed thirty years of Delaware case law upholding the validity of rights plans, including the seminal [\*Household\*](#) and [\*Unocal\*](#) decisions in 1985, as well as then-Vice Chancellor (and now Chief Justice) Strine's [\*Barnes & Noble\*](#) decision in 2010. The Court's decision highlights the continued vitality of rights plans in the face of ever-evolving threats to corporate effectiveness. Rights plans are not a cure-all for activist attacks, but, in appropriate circumstances, they remain an important tool for directors.

Andrew R. Brownstein  
Paul K. Rowe  
George T. Conway III  
Stephen R. DiPrima  
William Savitt

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