Poison, Chewable Pills, and More

by Robert W. Wood • San Francisco

The media that is having a feeding frenzy with articles about hot new pharmaceuticals and the various clones now being developed. Whether for this or other reasons, poison pill plans of various sorts are still in the news. Last month we noted a number of recent poison pill plans and their primary tax effects. See Wood, "More Poison Pill Plans," Vol. 6, No. 11, *M&A Tax Report* (June 1998), p. 1. Now, a brief second dose is in order.

America Online, Inc. has recently announced a more stringent poison pill plan, lowering the ownership threshold that would trigger the provisions of the plan significantly. AOL's original shareholder rights plan (the euphemism for a poison pill plan) was adopted in 1993, and was triggered only if an acquirer amassed 25% of AOL's shares.

The new plan, however, will be activated if an acquirer buys more than 15% of AOL shares. Upon the triggering event, AOL's poison pill plan would effectively double the number of shares outstanding,

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thus diluting the would-be acquirer's stake in the company. See "Board Votes to Strengthen Shareholder-Rights Plan," *Wall Street Journal*, May 15, 1998, p. B4. BancTec, Inc. has also adopted a new poison pill plan, replacing their earlier plan that expired. The threshold in the new BancTec plan is 20%, triggering the right to acquire shares at a discount. See "BancTec's New Poison-Pill Plan," *Wall Street Journal*, June 1, 1998, p. B5.

Pills are not limited to domestic use either. Belgium's Generale Bank recently triggered a poison pill plan that severely undercut ABN-Amro Holding NV's takeover plans. See DuBois, "Generale Bank Triggers Poison Pill to Thwart ABN-Amro Bid; Move Leaves Fortis As Likely Victor," *Wall Street Journal*, June 8, 1998, p. A16.

Chewable vs. Regular

Finally, given the number of jokes currently circulating about Pfizer's impotence drug Viagra, it is somehow appropriate that the *Wall Street Journal* carried a letter to the editor from Pfizer Vice President, Terence Gallagher, concerning the difference between regular poison pills and so-called "chewable" poison pills. See "Wait! Don't Take that Pill," *Wall Street Journal*, May 28, 1998, p. A23.

Mr. Gallagher's basic point is to criticize the recent *Journal* article suggesting that chewable poison pill shareholder rights plans should be adopted. See Macy, "A Poison Pill that Shareholders Can Swallow," *Wall Street Journal*, May 4, 1998.

Mr. Gallagher defends the notion that pills are appropriate barriers when the threshold is set at a figure such as 25% of the target's stock. However, he also notes the trend that directors may remove poison pills when they find that the takeover offer is in the interest of shareholders. When boards do remove poison pill plans, he states, the motivations are not questioned. Conversely, he implicitly questions situations where the directors leave the poison pill plan in place and reject takeover offers. There can be an understandable concern that they are protecting jobs rather than seeking to protect and preserve shareholder value.

In a "chewable" poison pill plan, the decision is taken out of the board's hands. To make a normal poison pill plan into a chewable pill plan, an arbitrary premium (say 25%) is set as the price for taking the target's directors out of the driver's seat. If widely adopted, Mr. Gallagher notes, the chewable pill would essentially make a 25% premium the going price for cash takeovers. Presumably transactions where more traditional poison pill plans (of the non-chewable variety) have resulted in nearly 100% premiums over share prices would simply not occur.

Poison Pill Plans Help

To generate value for shareholders, of course, poison pill plans of the traditional variety are helpful in upping the ante. Mr. Gallagher notes that Lotus and IBM both involved enormous additional value being wrung out of the initial offer. The chewable pill, he argues, fails to force a non-independent board to act on a stock for stock or hybrid stock and cash takeover offer. In dealing only with cash offers, the chewable pill can only handle a portion of the takeover offers that shareholders might have concern over. Indeed, in the situations where it does not apply, the chewable pill plan could hurt shareholders by setting an artificially low premium expectation. It may even create an incentive for acquirers to offer cash instead of stock, making the chewable pill particularly harmful to shareholders who would prefer a tax-free acquisition.

Finally, Mr. Gallagher points out that if shareholders are concerned that their directors would sacrifice shareholder interests in a takeover battle, then they may have a far more serious problem. Directors have responsibility for management oversight, monitoring management's legal compliance, evaluating management's performance, and setting management compensation and benefits. If the board is easily swayed by the special interests of management, he argues, there may be problems in the board's handling of other crucial matters as well.

Last Dose

Gallagher's conclusion, after all this, is that a chewable pill plan merely tries to treat one symptom of a serious shortcoming in corporate governance. A better solution, he says, is to improve the independence of the board of directors. ■