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More Poison Pill Plans

by Robert W. Wood • San Francisco

A couple of recent poison pill plans have received press coverage, and prompted renewed interest into the seemingly ever-present device, even in the 1990s. Texaco received wide notice for taking the unusual step of putting a poison pill plan up for a shareholder vote. At its recent shareholders' meeting, the company put up for shareholder approval a poison pill plan even though commentators noted that it could have simply have rammed it down the shareholders' throats. See Luvlin and Scism, "Texaco Plan for Poison Pill is Up for Vote," *Wall Street Journal*, April 23, 1998, p. C1.

Some features of the Texaco poison pill plan have been viewed as unusual. The average poison pill plan, of course, is designed to force hostile bidders to raise their prices. On

Continued on Page 3

ALSO IN THIS ISSUE:

POISON PILL PLANS Continued from Page 1

the other hand, shareholder groups may be against them since any sort of anti-takeover measure can serve to entrench weak management and defeat takeover bids that shareholders might actually welcome. A poison pill plan generally works by triggering the issuance of huge amounts of stock in the event of an unwanted bid, thus making a takeover of the company prohibitively expensive to the prospective acquirer.

A Rose is a Rose?

Although best-known by their "poison pill" moniker, the more than 2,000 public U.S. companies that now have poison pill plans generally now refer to them as "shareholder-rights plans." This rather creative euphemism may make some shareholders welcome the plans. However, as articles about the Texaco votes point out, most shareholders-right plans (or call them what they are, poison pills!) never see a shareholder vote.

Indeed, shareholders introduced and voted upon resolutions at 18 companies last year that sought to give them a larger voice in the use of poison pills, or to kill the poison pill plan outright. *Id.* However, these shareholder ballot measures (largely nonbinding) won an average of nearly 55% of the ballots cast. According to one report, this 55% figure for such a matter represents an all-time high. *Id.*

In Texaco's case, it defends the need for a takeover defense program because, so its proxy statement argues, control of Texaco could be acquired on the open market without fair value being offered to all shareholders. A Texaco spokesman views Texaco's pill as significantly different than any other. First, the plan would last only five years, instead of the usual ten. Texaco's anti-takeover pill also includes a "chewable" feature, meaning the company would dissolve the takeover defense if it receives a fully-financed, all cash tender offer to all shareholders. Finally, the threshold for the trigger of the poison pill would be the point at which a prospective acquirer bought 20% of the stock. This 20% trigger level is much higher than the usual 10-15% common to most poison pill plans.

Whether one generally favors poison pills or not, there are many who commented about Texaco's plan and about Texaco's huge market capitalization. A spokesman for Institutional Shareholder Services even views Texaco's market cap as so large that it would be highly unlikely that Texaco could be the target of an all-cash hostile tender offer that also provides shareholders with a suitable premium. See Lublin and Scism, "Texaco Plan for Poison Pill is Up

Continued on Page 4

 Continued from Page 3

for Vote," *Wall Street Journal*, April 23, 1998, p. C1.

Other Pills

In this Viagra-conscious climate, other pill plans have been adopted, too. Source Media, Inc., based in Dallas, has recently adopted a poison pill plan giving shareholders the right to purchase one share for $65 in the event of an attempt to acquire the company. See "Poison-Pill Defense Plan is Set by Interactive Firm," *Wall Street Journal*, April 27, 1998, p. B4. Source Media said that their plan is triggered when a personal group acquires 15% or more of the company's common stock.

Tax Effects

The tax status of poison pill plans was unclear until Revenue Ruling 90-11, 1990-1 C.B. 10. In that ruling, the IRS concluded that contingent rights awarded under such plans do not create income, because the plan is contingent upon a tender offer or acquisition. The ruling also concluded that such a plan does not constitute an option for purposes of Section 382. However, Revenue Ruling 90-11 does not address poison pill plans in general, just the specific plan that was considered in that ruling.

The ruling indicates that, at least for purposes of Section 382 attribution rules, it will apply only when rights are "similar" to those issued under the plan described in the ruling. Rights are "similar" if the principal purpose for adopting the plan is to establish a mechanism by which a publicly held corporation can provide shareholders with rights to purchase stock at substantially less than fair market value as a means of responding to unsolicited offers to acquire the corporation.

Testing Pills

This may seem to be an easy test to meet in virtually every case. After all, that is what poison pill plans are all about. Likewise, it should be fairly easy to establish that the principal purpose of the plan must be to provide rights to public shareholders to buy stock at a discount as a means of defeating a hostile takeover bid. However, in determining that the adoption of the poison pill plan will not be viewed as a distribution, exchange or any taxable event to the company or its shareholders, the IRS does not address in Revenue Ruling 90-11 the need for similarity to the model plan described in the ruling.

An additional element is just how important it is that the adopting company have a right to pull the plug on the pill rights. In the plan considered in Revenue Ruling 90-11, the company retained a right to terminate the pill rights. This termination right was exercisable by the company for a limited number of days after the rights were issued (pursuant to one of several specified triggering events). As the price for exercising this termination right, the company would have the right to make a small cash payment to the holders of the rights, effectively for stalling the ability of the rightholders to acquire additional stock for the bargain price.

Last Word

Although not all poison pill plans follow the format set out in Revenue Ruling 90-11, there has been no suggestion as of yet that the no-tax-consequence ruling will not be applied to all of these arrangements. After all, if the distribution of poison pill rights were held to be taxable, it is likely that recipient shareholders would be even less happy about the adoption of poison pill plans than they typically are already. On this note, perhaps Texaco's recent approach to put the pill plan up for a shareholder vote may portend less shareholder hostility about poison pill plans in general. ■