Prudential, Allergan, and Tokos Medical Adopt Poison Pill Plans

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Poison pill plans have recently come into the news in a big way, with the adoption of plans by Prudential Securities, Inc., Allergan Inc., and Tokos Medical Corp. One of the typically overlooked consequences of such plans is taxes. The Prudential plan (applicable to Prudential's oil and gas partnerships) was adopted as part of an effort to thwart a tender offer by George Kaiser. It calls for a form of equity protection.

If more than 15% of the interests of a particular partnership are acquired by someone not approved by the general partner, then the partnership interest holders would have to be paid the difference between the equity protection amount and the tender offer price. (See "Prudential Unit Adopts 'Poison Pill' To 'Thwart Bid for Oil, Gas Partnerships," *Wall St. J.*, 5/3/93, p. B14.) The

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poison pill greatly increases the cost of the partnerships to a prospective bidder.

The Allergan plan was proposed by the State of Wisconsin Investment Board, and passed by the shareholders, but had been opposed by the company itself. (See "Allergan Shareholders Pass Proposal Forcing Vote on 'Poison Pill'," *Wall St. J.*, 4/28/93, p. B2.)

The Tokos Medical Corp. plan was enacted to fend off unwanted takeover offers just a day after a significant drop in the price of the company's stock. The company said the rights were not distributed in response to any specific effort to acquire control of the company, and that the distribution had been planned for some time.

Shareholders were distributed a package of rights, including the right to buy stock at half its trading price if a person or group buys, or offers to buy, 20% or more of Tokos' stock. An acquirer seeking such a stake in Tokos, though, would be barred from buying stock at half price. The shareholder rights can be redeemed by the company within ten days of any takeover effort for a penny each. (See "Plan Is Enacted to Fend Off Unwanted Takeover Efforts," *Wall St. J*, 3/22/93, p. A2).

Tax Effects Overlooked?

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

Indeed, the ruling indicates that, at least for purposes of the Section 382 option 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. That would seem to be an easy test to meet in virtually every case.

Unanswered Questions

The importance of various elements in the plan considered in *Rev. Rul.* 90-11 remains unclear. With respect to the first element, the determination that the adoption of the plan will not be viewed as a distribution, exchange, or any other taxable event to the company or its shareholders, the need for similarity to the model plan in the ruling is not addressed. Another element—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 bid—should be fairly easy to satisfy.

An additional element is how important it is that the adopting company have a right to "pull the plug" on the pill rights. In the plan in the ruling, the company retained a right to terminate the pill rights. The termination right was exercisable by the company for a limited number of days even 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 to make a small cash payment to the holders of the rights, effectively forestalling their ability to acquire additional stock for the bargain price.

Conclusion

Of course, not all pill plans follow the format set out in *Rev. Rul.* 90-11. Nevertheless, there has been no suggestion yet that the no-tax-consequence ruling will not be applied to all of these arrangements. In any case, with the shifting nature of current poison pill plans, presumably more attention will be paid to the features of such plans in light of the criteria set out in *Rev. Rul.* 90-11. Hopefully, the Service will not be too critical of poison pill plans that do not fit the exact format of the ruling. After all, if the distribution of pill rights were taxable, it is likely that recipient shareholders would not be too happy. ■