

Dealpolitik: Are Poison Pill Takeover Defenses Unconstitutional?

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Two prominent corporate law professors are [arguing in a paper](#) soon to be published in the Columbia Law Review that the ubiquitous poison pill used by target companies to defend against hostile takeovers is vulnerable to being challenged as unconstitutional.

A poison pill—more formally called a shareholder rights plan—is a complex security distributed to shareholders which has the effect of prohibiting a takeover without the approval of the target's board. So anyone who wants to make an offer to shareholders opposed by the directors needs to replace the directors.

That usually takes months and, in the case of target companies with staggered boards (where directors serve staggered three-year terms), even years.

If some courts were to throw out poison pills, that could change the whole takeover game. Hostile bids could be completed in as little as four weeks. And activist shareholders might be able to acquire control of a company as a result of market purchases.

In reaching the conclusion that courts may someday reject poison pills as unconstitutional, Professors Lucian Bebchuk of Harvard and Robert Jackson of Columbia look back at two U.S. Supreme Court cases decided in the 1980s, in the relatively early days of takeovers.

Before 1968 there was essentially no federal regulation of takeovers. In that year, Congress adopted the Williams Act (named after then Senator Harrison Williams who later went to prison in the Abscam scandal dramatized in the movie *American Hustle*) to regulate hostile tender offers.

The Williams Act, the Supreme Court later concluded, was an effort by Congress to balance the interest of bidders and targets. It provides, for example, minimum time periods that tender offers needed to remain open.

As hostile tender offers became more common in the 1970s and 1980s, state legislatures stepped in to try to regulate them. Those laws were challenged by bidders as unconstitutional because it was argued that Congress had preempted the rights of states to impose additional burdens on hostile bidders.

In 1982, the U.S. Supreme Court agreed and ruled the Illinois takeover act unconstitutional [in a case called *Edgar v. Mite*](#).

Prof. Bebchuk and Jackson point out that there are two reasons the court threw out the Illinois statute. First, it opened up the possibility of extensive delays on hostile tender offers even though

the Williams Act itself set out the timing for such offers. Second, Justice White noted that the policy behind the Williams Act was to protect investors “while maintaining the balance between management and the bidder.” Once the investors were given the required information, Justice White said, the policy of the Williams Act was that investors should “be free to make their own decisions.”

Poison pills, the professors argue, have the same infirmities. They can be used to delay an offer—possibly to the point of the bidder walking away—and they can deprive the shareholders the opportunity of making their own decisions even after all required information is disclosed. Since poison pills are authorized by state law, if they are challenged, there is a risk they will also be struck down, according to Profs. Bebchuk and Jackson.

The paper has already stirred up a hornets’ nest of controversy. Martin Lipton and several other partners at Wachtell, Lipton, the law firm that essentially invented the poison pill, have [lobbed a robust attack](#) on the on the law professors’ paper, calling it, among other things, “misleading” and “not a work of serious scholarship.” They claim it is part of “Professor Bebchuk’s extreme and eccentric campaign against director-centric governance.”

That is a reference to numerous other exchanges between Prof. Bebchuk and Mr. Lipton over, among other things, shareholder activism and Prof. Bebchuk’s [Shareholder Rights Project](#) at Harvard. That project has successfully been pushing public companies to eliminate their staggered boards and have all directors stand for election each year. Elimination of staggered boards makes hostile takeover bids easier, as would the elimination of poison pills.

Profs. Bebchuk and Jackson have [defended the analysis](#) in their paper and have said it “touches a sensitive nerve at” Wachtell given the firm’s history with the poison pill.

Scholarly articles by law professors predicting a change in the law frequently gather dust on shelves (or in more modern parlance, are archived on hard drives). And invalidating poison pills almost 30 years after they were first judicially blessed by a Delaware court seems to me like a long shot.

Nevertheless, because of the prominence of the authors, it is likely we will see bidders or shareholders who want to accept a bid at least try to get poison pills thrown out on this basis. Profs Bebchuk and Jackson have some advice for state legislators who want to preserve poison pills. Five years after *Edgar v. Mite* the Supreme Court upheld one of a new generation of state takeover laws. The court [essentially said](#) that the statute was OK because the delay was only 50 days and ultimately, after that 50-day period shareholders were able to make the decision about the takeover bid. Thus, the authors argue that if poison pills are to be protected from constitutional challenge, state legislatures should limit the period that a board can use a poison pill as a blocking mechanism for a hostile bid.

That advice fits into Prof. Bebchuk’s other writings and activities. He is not a supporter of giving directors extensive powers to block shareholders from exercising their powers to sell their shares or replace directors.

Don't expect target boards to give up on their poison pill defenses any time soon. But there could well be a few fights in the future over their constitutionality.