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The International Comparative Legal Guide to:

Mergers & Acquisitions 2012

A practical cross-border insight into mergers and acquisitions

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EDITORIAL

Welcome to the sixth edition of *The International Comparative Legal Guide to: Mergers & Acquisitions*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of mergers and acquisitions.

It is divided into two main sections:

Six general chapters. These are designed to provide readers with a comprehensive overview of key issues affecting mergers and acquisitions, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in mergers and acquisitions in 40 jurisdictions.

All chapters are written by leading M&A lawyers and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor Michael Hatchard of Skadden, Arps, Slate, Meagher & Flom (UK) LLP, for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The International Comparative Legal Guide series is also available online at www.iclg.co.uk

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The Search for Deterrence: Derivatives Clauses in Shareholder Rights Plans

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I. Introduction

Pressure from activists to put the company up for sale has become a common concern of many corporate boards, especially as the stock market has struggled over the past few years. This concern can be compounded by activist investors' ability to fly under the radar through the use of derivative securities permitting an activist to build up a substantial economic position without the requirement of public disclosure. The technology in shareholder rights plans to deter these tactics has evolved and we examine in this chapter two approaches to deterrence through inclusion of derivatives in shareholder rights plans.

Activists can build their economic position in a company through the acquisition of derivative securities, rather than by purchasing the company's stock. An investor who enters into a total return swap ("TRS")¹ is in substantially the same economic position as if the investor owned the company's shares. But if the investor does not have the contractual right to vote or acquire the shares held by its swap counterparty (as it normally does not), the investor may not be deemed to be the beneficial owner of the underlying shares under the federal securities laws.² In that case, the investor would not have to report its position in the company's shares on Schedule 13D or Schedule 13G, even if its economic position exceeded five percent of the outstanding shares, as long as the investor's "physical" position was less than five percent. Similarly, if the company had a shareholder rights plan that used the securities laws definitions to determine an investor's beneficial ownership, the investor could accumulate an economic position through derivatives in excess of the threshold amount under the rights plan without triggering the rights plan, provided that the investor's physical position remained below the threshold.

In order to prevent activists from using derivatives to accumulate a position in excess of the rights plan ownership threshold, companies adopting a rights plan now commonly define beneficial ownership in the rights plan to include ownership of derivative securities, whether or not such securities confer beneficial ownership of the corresponding shares under the securities laws. Three quarters of the rights plans summarised in Table 1 below, which we believe is a representative sampling of plans newly adopted in 2011 or early 2012, include derivative securities in the calculation of beneficial ownership.³ However, while derivative securities clauses have become a standard feature of newly adopted rights plans, there are significant differences in how derivatives are

treated in determining whether an investor has exceeded the ownership threshold for triggering a rights plan and in their dilution effect on an activist who triggers the pill.

A majority of the rights plans with derivatives securities clauses follow the so-called "Full Ownership Approach" which treats an investor as the beneficial owner of shares – for the purpose of the threshold triggering the pill but not for the purpose of invalidating the associated rights – to the extent that the investor is a party to contractual arrangements that give it the economic equivalent of share ownership.^{4/5} A significant minority of rights plans, including those adopted in some of the most prominent takeover contests of the past year, follow the so-called "Full Dilution Approach" which treats the holder of a long derivatives position as the beneficial owner of shares – for the purpose of the threshold triggering the pill and for the purpose of invalidating the associated rights – held directly or indirectly by the counterparty under its derivatives contract up to the size of its derivatives position.⁶ The Full Ownership Approach and Full Dilution Approach are not just two different techniques for achieving the same substantive result. The two methods may result in differing calculations of the percentage of the shares owned by an investor, and may have widely different impacts on the amount of dilution suffered by a holder of derivative securities who triggers the rights plan.

This chapter reviews the two types of derivatives clauses: how their effects differ; and their relative strengths and weaknesses. After completing this review, we conclude that the Full Dilution Approach is the better choice for most companies, because the Full Ownership Approach does not reliably perform the essential task of deterring activists from using derivatives to acquire a position in the company's stock in excess of the pill threshold.

II. Full Ownership V. Full Dilution: Which do Companies Choose?

Among recently adopted or amended rights plans that explicitly address derivatives, a majority have taken the Full Ownership Approach. A recent examination found that between January 1, 2009 and February 28, 2011, a large majority of such rights plans incorporated some form of the Full Ownership Approach.⁷ Table 1 below summarises the treatment of derivatives in 16 rights plans that were newly adopted in 2011 and early 2012.

Table 1: Overview of Recently Adopted Shareholder Rights Plans

Adoption Date (U.S.)	Company	Reason for Adoption	Type of Derivative Provision
1.25.2012	Illumina Inc.	Hostile Bid	Full Ownership Approach
1.16.2012	Georgia Gulf Corporation	Hostile Bid	None
1.13.2012	CVR Energy, Inc.	Accumulation by Activist Investor	Full Ownership Approach
9.22.2011, amended 12.11.2011	Cracker Barrel Old Country Store, Inc.	Accumulation by Activist Investor	Full Dilution Approach
9.6.2011	Central European Distribution Corporation	Accumulation by Activist Investor	Full Ownership Approach
8.25.2011	PharMerica Corporation	Hostile Bid	None
8.24.2011	Collective Brands, Inc.	N/A	Full Ownership Approach (Board Trigger)
8.01.2011	The Talbots, Inc.	Accumulation by Activist Investor	Full Ownership Approach
7.30.2011	Commercial Metals Company	Accumulation by Activist Investor	Full Ownership Approach
7.26.2011, amended 11.20.2011	Transatlantic Holdings, Inc.	Hostile Bid	Full Ownership Approach
7.18.2011	The Clorox Company	Hostile Bid	Full Dilution Approach
6.7.2011, amended 9.6.2011	Temple-Inland Inc.	Hostile Bid	Full Dilution Approach
5.18.2011	Dollar Thrifty Automotive Group, Inc.	Hostile Bid	None
5.4.2011	Ralcorp Holdings, Inc.	Hostile Bid	Full Ownership Approach
4.20.2011	McCormick & Schmick's Seafood Restaurants, Inc.	Hostile Bid	Full Ownership Approach
3.2.2011	Family Dollar Stores, Inc.	Hostile Bid	None

Three quarters of the rights plans in Table 1 defined beneficial ownership to include ownership of derivatives, and among the plans which had a derivatives clause nine used the Full Ownership Approach and three used the Full Dilution Approach. While the Full Dilution Approach appears in a minority, these included the rights plans adopted by the targets in three of the most prominent takeover contests of 2011 (Temple-Inland, Clorox and Cracker Barrel), all represented by the same law firm, Wachtell, Lipton, Rosen & Katz.

III. Evaluating the Two Approaches

A derivative securities clause in a rights plan would ideally have the following characteristics:

- it would enable the investor to know when it was triggering the rights plan ("*Investor Transparency*");
- it would enable the company to know when the investor had triggered the rights plan and to administer the issuance of shares in respect of the rights after the rights plan has been triggered ("*Company Transparency*");
- it would reliably deter the investor from triggering the rights plan ("*Deterrence*"); and
- it would have a strong chance of being upheld by the courts ("*Legal Enforceability*").

The chart below contains our report card for the two approaches, based on their success in achieving each of these objectives. While neither approach is perfect, the Full Dilution Approach appears superior because of its greater success at the critical task of deterring an investor from triggering the pill. The following section evaluates each approach in terms of its success at meeting these criteria:

Report Card Full Ownership Approach	
Investor Transparency	B+
Company Transparency	C-
Deterrence	C
Legal Enforceability	B+

Report Card Full Dilution Approach	
Investor Transparency	B-
Company Transparency	C-
Deterrence	A
Legal Enforceability	B

A. Full Ownership Approach

1. Investor Transparency

This might seem to be a significant advantage of the Full Ownership Approach. An investor knows how large its physical and derivative positions are. It can also estimate the company's outstanding shares based on publicly available information. Using these amounts, the investor should be able to determine whether the acquisition of additional physical or derivative shares will take the investor above the pill's threshold.

The typical language of the Full Ownership Approach may create an ambiguity in the calculation of the denominator of shares outstanding since an investor could argue that this type of provision turns derivatives investors into beneficial owners by, in effect, creating new shares rather than by treating the derivatives investor as the owner of existing shares, as the Full Dilution Approach does. In that case, the Full Ownership Approach could be read to increase the number of shares outstanding, and thereby reduce the percentage owned by the investor after giving effect to the increase in the number of shares it beneficially owns. This ambiguity could lead to a dispute on the margin about whether a particular investor has crossed the ownership threshold.

Grade: B+

2. Company Transparency

Since both the Full Ownership Approach and the Full Dilution Approach are contractual, neither can fix the state of the securities law. Currently, an activist is not required to disclose its ownership position until it has beneficial ownership as defined under the federal securities laws of five percent or more and, therefore, the company may not be aware that the investor has triggered the pill. Some companies using the Full Ownership Approach have addressed this problem by including a double trigger which does not count derivative positions towards beneficial ownership unless the investor has beneficial ownership for SEC purposes of at least the five percent threshold for filing a Schedule 13D, which would require disclosure of the investor's derivative contracts.⁸ That addition may defeat the purpose of the clause as the investor can avoid the clause altogether by keeping its beneficial ownership for SEC purposes below five percent.

Once the company has determined that the pill has been triggered, the Full Ownership Approach is relatively easy to administer, because the investor is not deemed to be beneficial owner of the shares held by counterparties and therefore the company does not have the task of identifying those shares in order to void the related stock purchase rights. However, the facts underlying this ease of administration are ultimately a weakness of the Full Ownership Approach, as described below.

Grade: C-

3. Deterrence

This is the great weakness of the Full Ownership Approach. A rights plan normally deters an investor from triggering the pill by invalidating the rights of a stockholder who acquires shares in excess of the pill threshold (the "acquiring person"). But a derivative security does not receive any stock purchase rights under a rights plan. For the deterrent effect of the pill to work on derivative securities, the rights plan must invalidate the rights of the shares held by the investor's counterparty and the economic loss

suffered by the counterparty must be passed on to the investor through contractual arrangements that indemnify the counterparty. This critical process does not occur under a Full Ownership Pill because the investor is not treated as the beneficial owner of the shares held by the counterparty and, therefore, the shares held by the counterparty do not lose their rights when the pill is triggered.

One commentator has stated his belief that a Full Ownership Approach makes the derivatives investor the co-beneficial owner of the shares held by its counterparties and therefore the Full Ownership Approach would invalidate the rights attached to the counterparty's shares if the pill was triggered.⁹ That position may be hard to support unless the derivatives contract is tied in some way to the shares held by the counterparties, which is not the case in a typical TRS and many other derivatives. Absent language in the derivatives contract tying the contract to the counterparties' shares, the investor is unlikely to be treated as the beneficial owner of the counterparties' shares, and the Full Ownership Approach may not deter the investor from triggering the rights plan, unless the investor has such a large physical position in the company's shares that the invalidation of the rights associated with its physical shares is sufficient deterrence.

Grade: C

4. Legal Enforceability

A rights plan incorporating the Full Ownership Approach would seem to have a reasonably good chance of being upheld in litigation. An issue could possibly be raised about the uncertainty of the calculation of the threshold at which the pill is triggered under this clause, but we think it should not be an impediment to enforceability.

A decision of the board to adopt a defensive measure in response to a threat to corporate control is subject to the *Unocal* test. Under the *Unocal* test, as refined in *Unitrin v. American General*,¹⁰ in order for the business judgment rule to apply to a defensive measure against a takeover threat, the board must demonstrate that (1) it reasonably determined that the possible takeover posed a threat to legitimate corporate interests, and (2) the defensive measure was a reasonable response in proportion to the threat and not coercive or preclusive.

A board which adopts a rights plan with a derivative securities clause should be able to demonstrate that it reasonably determined that an economic position in the company's shares, based in whole or in part on derivative securities, in excess of the ownership threshold for triggering the pill, poses a legitimate threat to corporate interests. One such threat would be the ability of the derivatives investor to influence the voting of the shares held by its counterparties, even if it does not have the right to direct the voting of such shares. The voting of shares held by counterparties is a complicated subject influenced by policies that some institutions have against voting shares that they hold as counterparties or to vote such shares in proportion to the vote of other shareholders.¹¹ However, these policies are not universal, and investors with large derivative positions could have the ability to influence the voting of all or a substantial portion of these shares. Another threat sometimes mentioned is the risk that an investor could elect to unwind a swap and quickly gain control of the shares held by the counterparty to hedge its short position.¹² While this threat may be real at lower ownership levels, we question whether a derivatives investor would elect to unwind a swap and acquire the underlying shares at a level triggering the pill.

If the company can establish that derivative positions in its stock pose a threat, it should also be able to demonstrate that the inclusion

of derivative securities in the definition of beneficial ownership is a reasonable and proportionate response to that threat. Rights plans incorporating the Full Ownership Approach are less vulnerable than those using the Full Dilution Approach to the claim made in the *Atmel* litigation, discussed below, that a derivatives clause should not be enforceable because of the difficulty of determining an investor's beneficial ownership under that clause.¹³ The Full Ownership Approach treats the investor as the beneficial owner of the full amount of shares covered by its long derivative position, without regard to the number of shares owned by the counterparty. As discussed above under "Investor Transparency", some Full Ownership derivatives clauses are not clear on whether to increase the number of outstanding shares, for purposes of determining whether a pill has been triggered. Apart from that ambiguity, a rights plan incorporating the Full Ownership Approach is not vulnerable to the claim that it is too vague or uncertain to be enforced against an investor.

A company defending a rights plan incorporating the Full Ownership Approach should also benefit from the fact that most rights plans adopted in the past year follow the Full Ownership Approach, which was also the type of derivatives provision used in the rights plan upheld by the Delaware Court of Chancery in *Yucaipa*, although that provision was not directly at issue in the case.¹⁴ The *Yucaipa* court suggested that language in a rights plan that goes beyond what is customary will be more heavily scrutinised. In *Yucaipa*, the court ultimately upheld Barnes & Noble's rights plan after it was amended to remove a non-standard provision in the beneficial ownership definition which sought to capture persons acting together in concert. In upholding the amended rights plan, the court noted favourably that the amended definition was based on standard language: "as amended, the definition of beneficial ownership ... is no different than the language that has been incorporated into countless rights plans since Moran." Three quarters of the recently adopted rights plans summarised in Table 1 above contained some form of derivative provision, and of these a majority followed the Full Ownership Approach.

Grade: B+

B. Full Dilution Approach

The Full Dilution Approach gets a report card that looks very different from the report card received by the Full Ownership Approach. The Full Dilution Approach gets somewhat lower grades in Investor Transparency and Legal Enforceability, but does far better in the critical category of Deterrence.

1. Investor Transparency

Criticism of the Full Dilution Approach has focused on the issue of investor transparency. Activists have argued that an investor, building a large economic position in a company's stock through derivatives will not know whether it has triggered the pill, because it has no reliable way of determining how many shares are owned by its counterparties. While this statement may be theoretically correct, it exaggerates the practical problems that the Full Dilution Approach poses for an investor. A derivatives investor in a company with a rights plan incorporating the Full Dilution Approach can avoid triggering the pill by assuming that its counterparties own stock that is equal to or greater than the size of its long derivatives position.

This assumption not only protects the investor against triggering the pill, it is also likely to be correct to a great extent. Firms which act

as derivatives counterparties do so to earn fees for providing this service; they normally want to avoid building either a long or a short position in the securities with respect to which they act as counterparties. Therefore, the counterparties generally hedge their position by acquiring the underlying securities or by entering into swap transactions with other counterparties.¹⁵ The chain of counterparties commonly leads to a counterparty which holds a physical position in the underlying shares. In some instances, the ultimate counterparty may be an investor which has entered into a derivatives transaction in order to take a short position in the security, but this is the exception and not the rule. An investor always has the ability to ask its counterparties for information about their holdings of the company's shares; and if it learns that the counterparties' positions are not directly or indirectly hedged with physical shares, the investor can then increase its position (physical or derivative) in the company's shares without triggering the pill.

Grade: B-

2. Company Transparency

The Full Dilution Approach has the same weakness as the Full Ownership Approach in terms of company transparency as described above.

Under a rights plan incorporating the Full Dilution Approach, there are additional questions that must be answered once the size of the investor's position (physical and derivative) in the company's shares has been established. Even if the investor exceeds the rights plan ownership threshold, the investor would not trigger the pill unless the investor's counterparties (and the counterparties' counterparties) hold stock equal to or in excess of the investor's long derivative position (or enough of that position to bring the investor's beneficial ownership above the rights plan ownership threshold). Therefore, to establish definitively that the pill has been triggered, the ownership of these counterparties would have to be established.

While this administrative complication exists, it is likely to be of limited importance to the company, the investor and others trading in the company's securities. Once it is established that the investor's total position in the company (physical and derivative) is greater than the threshold under the rights plan, the interested parties are likely to conclude that the pill had been triggered, because the total stock ownership of all counterparties exceeds the investor's derivative position, even if the exact amount and distribution of such stock ownership has not been determined. Further, the contractual arrangements between the investor and its counterparties are likely to require the investor to bear the economic cost of triggering the pill, so the investor and the counterparties would not actually have an economic stake in determining which particular counterparty's stock purchase rights had been eliminated. Finally, in the aftermath of the triggering of the *Selectica* rights plan in 2009, rights plans now typically include a provision allowing the shares in respect of the rights to be issued into trust, while a determination is proceeding about which particular rights are and are not exercisable.¹⁶ Therefore, it seems likely that any disputes would be quickly settled once it was determined that the investor's total position in the company's securities exceeded the threshold for triggering the pill.

Finally, it is important to bear in mind that the reason for these administrative complications is to achieve the deterrent effect described below. Therefore, a company which adopts a rights plan incorporating the Full Dilution Approach receives an ample reward for assuming the burden of administering this type of rights plan,

and in all likelihood it will never have to shoulder that burden because an investor in a company with a rights plan incorporating the Full Dilution Approach will be deterred from triggering the pill.

Grade: C-

3. Deterrence

This is the great advantage of the Full Dilution Approach. Because an investor with a long derivative position is treated as the beneficial owner of shares held by its counterparties, the stock purchase rights in respect of those shares are voided when the investor triggers the pill. Initially, the loss of those stock purchase rights fall upon the counterparties, but the contractual arrangements between the investor and the counterparties should be crafted to cause the burden to be absorbed by the investor, either by operation of the clauses in the swap agreement that measure the return on the company's shares or through indemnification clauses in their agreements. This is a fair result for the investor since the purpose of these derivative contracts is to put the investor in the same economic position as if it held a physical rather than a derivative position in the company's stock.

Grade: A

4. Legal Enforceability

The discussion of Legal Defence under the Full Ownership Approach also applies to the Full Dilution Approach, with three differences:

- First, the argument that the rights plan increases the number of outstanding shares for purposes of calculating an investor's percentage ownership (thereby increasing the number of shares that an investor must beneficially own before the pill is triggered) would not apply to the Full Dilution Approach, which operates by attributing ownership of the counterparty's shares to the investor, rather than by creating new shares which are deemed to be beneficially owned.
- Second, the Full Dilution Approach is not yet as common as the Full Ownership Approach, and therefore a rights plan incorporating the Full Dilution Approach may not benefit to the same extent from the positive statements made by Chancellor Strine in *Yucaipa* about customary rights plan provisions. However, derivatives clauses in general have now become customary in newly adopted rights plans and the difference between the two clauses should not be great enough to impact the result in litigation.
- Third, a litigation involving a rights plan incorporating the Full Dilution Approach is likely to include a claim that the pill should be unenforceable because the investor may not be able to determine the number of shares owned by counterparties and therefore may not be able to determine with certainty whether the acquisition of an additional interest in the company's shares (physical or derivative) will trigger the pill.

This last point was the central issue in the *Atmel* case in which a shareholder sought an injunction to prevent Atmel from amending its rights plan to include a derivatives clause following the Full Dilution Approach.¹⁷ Chancellor Chandler denied the injunction because the plaintiff failed to provide sufficient evidence of how the derivatives clause would work in practice if it were triggered. Therefore, Chancellor Chandler's opinion leaves open the possibility that with an adequate record he could have been convinced that "the amendment renders the rights plan fatally vague, ambiguous, or incapable of enforcement". However, given

the emphasis on how the Full Dilution Pill would work in practice, the outcome in *Atmel* suggests that the risk that a court would enjoin such a rights plan before it is triggered is small, and the Full Dilution Approach would only face its most serious test in court in the unlikely event that an investor chose to buy through the pill threshold and run the risk of being diluted by the rights plan.

In the "Investor Transparency" and "Company Transparency" discussions of the Full Dilution Approach above we explained why the practical problems presented by the Full Dilution Approach were manageable. In particular, an investor could protect itself by assuming that it would trigger the pill if its derivative and physical ownership of the company's stock reached the threshold prescribed in the rights plan. If the investor wished to acquire additional shares, it could ask its counterparties about their position in the company's shares, and could increase its ownership if it learned that the counterparties (including the counterparties' counterparties) did not own shares equal to or greater than the investor's derivative position. Based on this analysis of the situation of a derivatives investor under a pill incorporating the Full Dilution Approach, it seems that the Full Dilution Approach does not place an unreasonable burden on the derivatives investor. However, given the basis on which the *Atmel* case was decided, the claims made in that case can be expected to reappear in future litigation involving the Full Dilution Approach, and therefore the litigation risk of that type of rights plan is probably somewhat greater than the risks associated with a Full Ownership Approach.

Grade: B

IV. Conclusion

Rights plans with derivative securities clauses have one fundamental purpose: to deter investors from using derivatives to build a position in the company's shares in excess of the ownership threshold under the plan. Viewed in the light of that purpose, rights plans incorporating the Full Ownership Approach have a fundamental weakness: they may not impose an adequate economic penalty on an investor that uses derivatives to accumulate an economic position in the company's shares in excess of the rights plan threshold and triggers the pill. A company adopting a rights plan with a derivative securities clause cannot be confident that the Full Ownership Approach will deter the activists who may wish to build a position in the company's securities.

The Full Dilution Approach provides the assured deterrence that the Full Ownership Approach lacks. While the Full Dilution Approach carries the higher administration burden, and additional issues that could be raised in a litigation, those issues are manageable and, importantly, are unlikely to ever arise if the Full Dilution Approach is successful at deterring investors from buying through the ownership threshold. We believe that the Full Dilution Approach has an effective dilution mechanism, while the Full Ownership Approach does not, and therefore the Full Dilution Approach would ordinarily be the better approach for a company which wants to have a rights plan that is effective at deterring activist investors from accumulating an economic position in the company's stock in excess of the rights plan threshold.

Endnotes

- 1 A TRS is a type of derivative instrument in which one party agrees to pay an amount equal to the income stream from a specified number of shares in a designated company's stock (the short party), in exchange for the other party agreeing to pay a specified interest rate on a specified principal amount

(the long party). The short party to a TRS may, but is not required to, hedge its exposure by actually purchasing the shares of common stock referenced in the TRS agreement. We understand that the short party usually does hedge its position.

- 2 In *CSX Corp. v. The Children's Inv. Fund Mgmt.*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), the District Court held that pursuant to Rule 13d-3(b) the long party to a TRS was the beneficial owner of the common stock referenced by the TRS because the long party was using the TRS as part of a plan to evade the Section 13(d) reporting requirements. However, the district court did not find that the TRS itself conveyed beneficial ownership to the long party. On appeal, the Second Circuit could not reach a consensus on the issue of whether and when a TRS confers beneficial ownership under Rule 13d-3. See 654 F.3d 276 (2d Cir. 2011). Moreover, the SEC still has yet to issue any rules under the Dodd-Frank Act to provide more clarity on when a derivative instrument confers beneficial ownership.
- 3 Table 1 does not include any so-called "NOL Pills" which have the specific purpose of deterring the accumulation of stock ownership positions which would jeopardise a company's net operating losses.
- 4 For example, the following language was included in the rights plan recently adopted by Illumina, Inc.: "A Person shall be deemed the "Beneficial Owner" of and shall be deemed to "Beneficially Own" any securities: . . . which are the subject of (or synthetically owned pursuant to) (A) a Derivative Transaction entered into by such Person or such Person's Affiliates or Associates or (B) a derivative security acquired, directly or indirectly, by such Person or such Person's Affiliates or Associates." Rights Agreement, dated as of January 26, 2012, by and between Illumina, Inc., and Computershare Trust Company, N.A. Exhibit 4.1 to Illumina, Inc.'s Current Report on Form 8-K, dated January 26, 2012.
- 5 Certain, more narrowly tailored, variations of the Full Ownership Approach have also emerged. For instance, some rights plans provide that derivative positions will not be included for purposes of determining beneficial ownership unless the holder beneficially owns a minimum percentage of actual shares (e.g., 5%) (the "Double Trigger"). Other rights plans require the target company's board of directors to determine that a person is seeking to use its derivative position for the purpose of changing or influencing control of the company before that person's derivative position will be included for purposes of calculating its beneficial ownership (the "Board Trigger"). Rights plans that include a Double Trigger or Board Trigger mechanism still calculate beneficial ownership based on the notional shares covered by a derivative instrument, regardless of whether any actual shares are held by the relevant counterparty.
- 6 For example, the following language was included in the rights plan recently adopted by Cracker Barrel Old Country Store, Inc.: "A Person shall be deemed the "Beneficial Owner" of and shall be deemed to "Beneficially Own" any securities: . . . which are beneficially owned, directly or indirectly, by a Counterparty (or any of such Counterparty's Affiliates or Associates) under any Derivatives Contract (without regard to any short or similar position under the same or any other Derivatives Contract) to which such Person or any of such Person's Affiliates or Associates is a Receiving Party (as such terms are defined in the immediately following paragraph); provided, however, that the number of Common Shares that a Person is deemed to Beneficially Own pursuant to this clause . . . in connection with a particular Derivatives Contract shall not exceed the number of Notional Common Shares with respect to such Derivatives Contract; provided, further, that the number of securities beneficially owned by each Counterparty

(including its Affiliates and Associates) under a Derivatives Contract shall for purposes of this clause . . . be deemed to include all securities that are beneficially owned, directly or indirectly, by any other Counterparty (or any of such other Counterparty's Affiliates or Associates) under any Derivatives Contract to which such first Counterparty (or any of such first Counterparty's Affiliates or Associates) is a Receiving Party, with this proviso being applied to successive Counterparties as appropriate". Rights Agreement, dated as of September 22, 2011, between Cracker Barrel Old Country Store, Inc. and America Stock Transfer & Trust Company, LLC. Exhibit 4.1 to Cracker Barrel Old Country Store, Inc.'s Current Report on Form 8-K, dated September 22, 2011.

- 7 See Mark D. Gerstein *et al.*, *The Resilient Rights Plan*.
- 8 An investor who, directly or indirectly, is the beneficial owner of more than 5% of a corporation's stock must disclose certain information on either Schedule 13D or Schedule 13G. In calculating whether an investor beneficially owns 5% of a class of stock for purposes of Schedule 13D, many types of derivative instruments, including TRSs, may not be covered (see the discussion in Endnote 2 above). However, once an investor otherwise reaches the five percent threshold, Schedule 13D requires that the investor report all of its contractual arrangements relating to the corporation's stock, including any derivative contracts. Passive investors filing Schedule 13G, on the other hand, are not under a similar obligation to disclose their derivative positions.
- 9 See Daniel L. Serota, *Picking Your Poison*, *The M&A Journal*, July/August 2010, Vol.10, No.8.
- 10 Unitrin, 651 A.2d 1361.
- 11 See e.g., Mark D. Gerstein *et al.*, *The Resilient Rights Plan*, p. 16.
- 12 *In re Atmel Corp. S'holders Litig.*, C.A. No. 4161-CC, 102-103 (Del. Ch. May 19, 2009) (transcript).
- 13 See *id.*
- 14 *Yucaipa Am. Alliance Fund II, L.P. v. Riggio*, 1 A.3d 31 (Del. Ch. 2010).
- 15 Under the typical provision following the Full Dilution Approach the investor is treated as the beneficial owner of all the counterparty's shares, up to the full amount of the investor's long derivative position, not just the shares that the counterparties acquire to hedge against their exposure to this particular investor. So even if the counterparties hedge against a portion of their exposure by means other than acquiring physical shares (such as netting against their exposure to holders of short derivative positions), the total position of the counterparties in the company's shares may equal or exceed the investor's long derivative position.
- 16 See *Selectica, Inc. v. Versata Enterprises, Inc.*, C.A. No. 4241-VCN (Del. Ch. Feb. 26, 2010), *aff'd*, No. 193, 2010 (Del. Oct. 4, 2010). When the *Selectica* NOL rights plan was triggered in early 2009, the company's inability to quickly determine the identity of its stockholders resulted in a one-month suspension of the trading of *Selectica* stock while the company scrambled to ensure that its exchange shares were not being transferred to the acquiring person.
- 17 See *Atmel*, C.A. No. 4161-CC.

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