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The NOL Poison Pill: Preserving Your Valuable Tax Assets

Overview

Poison pills, also commonly referred to as Shareholder Rights plans, were first introduced in the early 1980s, in an environment of hostile takeovers. As a defense against hostile bidders and leveraged buyouts, target companies would implement poison pill plans to deter acquisitions by competitors and corporate raiders. Rights plans achieved this by distributing rights to purchase additional shares to the non-offensive shareholders at a discount, effectively diluting the hostile investor's ownership percentage. These purchase rights would be distributed once a triggering event had occurred, typically when an unwanted investor had acquired a 15% to 20% ownership stake.



NOL Poison Pill

NOL Poison Pills have recently gained prominence due to the impact of the recession. An NOL Poison Pill is a new type of shareholder rights plan, designed to protect the company's valuable tax attributes from being curtailed under the tax laws due to stock purchases by an aggressive suitor or a savvy competitor.

As a result of the recent recession, companies have incurred significant losses, creating Net Operating Loss (NOL) carryforwards. These NOL carryforwards can be used by the company to shelter future earnings and create positive cash flow, which can be used to pay down debt or expand operations. In some cases, a struggling corporation's NOL asset may have a far greater value than even the corporation's current market capitalization.

This NOL asset's usage may be reduced or eliminated under Section 382 of the Internal Revenue Code. If the company has more than 50% of its shares held by 5% or greater shareholders change hands in a three-year period, the NOL

carryforwards' usage may be severely limited, possibly rendering it worthless. In order to protect itself, a company may adopt a Shareholder Rights Plan, lowering the typical 15% to 20% stock purchase trigger in older plans to 4.99%, corresponding with the tax law's threshold. By doing so, companies with significant net operating losses may effectively protect these valuable tax assets.

Recent Developments

The legal justification to utilize a shareholder rights plan was in question until a recent decision by the Delaware Court of Chancery in *Selectica, Inc. v. Versata Enterprises, Inc.* In that case, Selectica adopted an NOL Poison Pill and subsequently, an aggressive competitor intentionally acquired more than 5% of the company's shares. Despite numerous warnings, the competitor refused to accede. To protect its NOLs, Selectica triggered the poison pill plan. The Delaware court affirmed Selectica's use of its Rights Plan as a reasonable response to the attack on the company.

Finally, even shareholder advocacy groups, who have long opposed Poison Pills as possibly entrenching a subpar management team have recently agreed to, and endorsed the use of NOL poison pills to boards of directors. In the past year, prominent companies such as Ford and Citibank have adopted shareholder rights plans in order to protect their tax attributes. While not likely takeover candidates, these large companies recognize the importance of protecting these valuable tax assets. What has your organization done to protect its tax attributes?

Contact information

Please feel free to contact me to discuss how True Partners can help you and your organization protect and utilize its tax attributes most efficiently.

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