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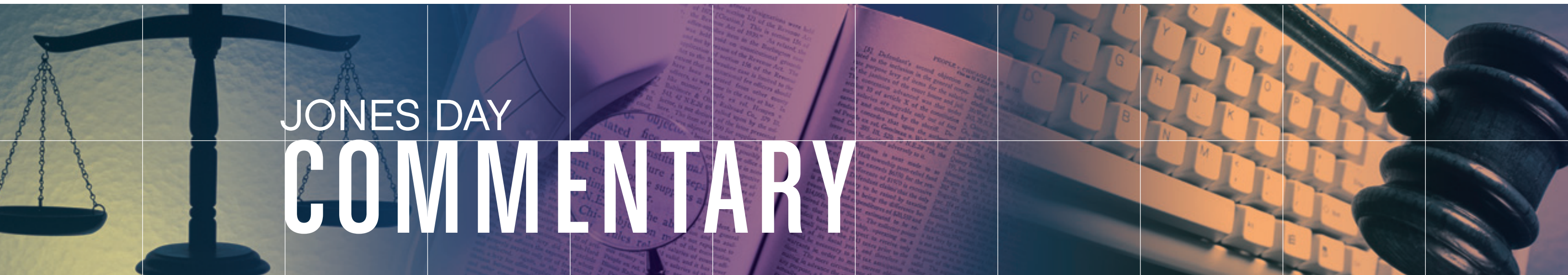

INVESTOR GROUP INTENTIONALLY TRIGGERS "POISON PILL"

Public companies have used shareholder rights plans, or "poison pills," as a takeover defense for more than 20 years. Rights plans are inadvertently triggered from time to time—a situation that is usually quickly remedied by board action and a subsequent sell-down by the triggering shareholder. No investor had ever intentionally triggered a modern "flip-in" rights plan, however, until December 2008, when Trilogy, Inc., and related parties disclosed that due to their purchase of additional shares of Selectica, Inc., they "purportedly became an 'Acquiring Person'" under the terms of Selectica's rights plan.

Selectica, a micro-cap company, adopted a rights plan with a 15 percent trigger in 2003. On November 11, 2008, Trilogy and related parties filed a Schedule 13D disclosing that they owned 5.1 percent of the outstanding Selectica shares (their ownership increased to 6.1 percent by November 17, 2008). On November 17, 2008, the Selectica board amended the plan to reduce the triggering threshold to 4.99 percent of the outstanding common shares, thereby converting the rights plan into a so-called "NOL rights plan." NOL rights plans, which are becoming increasingly common, are designed to reduce the risk that a company's ability to use its net operating losses and other tax assets is restricted due to the occurrence of an "ownership change," which would generally occur under the federal tax laws if cumulative changes in ownership by 5+ percent shareholders exceed 50 percent within a rolling three-year period. Selectica has stated that at the time of the rights plan amendment, its "ownership change" stood at approximately 40 percent and that its NOLs had a value of at least $150 million.

Selectica's NOL rights plan provided that individuals or groups who owned more than 4.99 percent of Selectica's shares at the time of the amendment would not trigger the plan unless and until they acquired an additional 0.5 percent of the outstanding Selectica shares. On December 18 and 19, 2008, the Trilogy parties purchased additional Selectica shares in excess of the 0.5 percent cushion and amended their 13D to disclose the purchases and their purported status as an Acquiring Person under the terms of the NOL rights plan.

On January 3, 2009, Selectica announced that its board of directors had invoked the exchange

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provision of the rights plan, under which one Selectica common share would be issued in exchange for each outstanding right issued pursuant to the plan, other than the rights held by the Trilogy parties, which would be void.[1] As a result of the issuance of common shares pursuant to the exchange provision, the Trilogy parties' position in Selectica's common shares was diluted from approximately 6.7 percent to roughly 3.4 percent. Further, since the rights issued pursuant to the existing plan expired upon the exchange, Selectica adopted a successor NOL rights plan with a three-year term and distributed the new rights to its shareholders. Nasdaq halted trading in Selectica shares on January 5, 2009, evidently to permit Selectica to complete the issuance of the new shares.

Selectica has filed suit in the Delaware Chancery Court seeking a declaratory judgment that its rights plans are valid. The defendants have counterclaimed for injunctive and declaratory relief, calling the rights plans the "Nuclear Pill" and the "Reloaded Nuclear Pill," asserting claims of breach of fiduciary duty against Selectica's directors and seeking a declaratory judgment that the rights plans are invalid. Discovery in the case is proceeding.

While this situation is unprecedented, it is best viewed not as a stand-alone event but as a new battle in a continuing war between Selectica and Trilogy. Selectica's complaint indicates that the parties have been involved in unrelated disputes, and it suggests that the deliberate triggering of the rights plan was designed to compel Selectica to settle those disputes. Trilogy's answer and counterclaim states that it had "sought repeatedly since 2005 to engage Selectica in a dialogue concerning a possible acquisition" but had been rebuffed, even though another investor had been permitted to take a 14.6 percent position in the company. The Trilogy parties assert that the NOL rights plan was a pretext adopted hastily after their initial 13D filing in order to block additional purchases by them. The cost to the Trilogy parties of triggering the rights plan was not very large (their investment was worth about $1 million and the dilution was roughly 50 percent), but it is still not completely clear why they intentionally exceeded the 4.99 percent ownership threshold.

Although Trilogy appears to assert that the Selectica rights plans are *per se* illegal and invalid by reason of their 4.99 percent triggering levels, we believe that it is unlikely that the Court will adopt any such *per se* rule and that it will instead evaluate the validity of the rights plans in the contexts of the specific circumstances in which they were adopted.

We are currently tracking more than two dozen NOL rights plans, many of which have been adopted in the past six months. We have represented several clients in converting their rights plans to NOL rights plans and in adopting NOL rights plans (and in some cases, charter amendments to impose transfer restrictions on 5+ percent holders).

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1 Alternatively, under the flip-in provisions of the rights plan, the board could have permitted each valid right to be exercised to purchase $36 in market value of Selectica shares upon payment of the $18 exercise price, which would have caused massive dilution to the Trilogy parties, given that the Selectica shares were trading at around $1 per share. Selectica would not, however, have had sufficient authorized shares to honor a flip-in.

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