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In December 2008, Versata Enterprises became the first stockholder to swallow a modern poison pill intentionally. Selectica had put the poison pill in place to protect one of its largest assets—net operating loss carryforwards (NOLs)—after a number of companies, including Versata, had become large block holders of its stock. Versata triggered the pill by purchasing shares in excess of the 4.99 percent threshold defined by the poison pill. In response, Selectica brought an action seeking a declaratory judgment on the validity of the pill and on the reasonableness of other defensive actions taken by Selectica’s board of directors under Unocal. Versata and its parent Trilogy countersued.

The case was tried in the Delaware Court of Chancery. Cornerstone Research worked with Selectica’s counsel and two testifying experts, Professor Merle Erickson of the University of Chicago Booth School of Business and Professor John Coates of Harvard Law School.

The Delaware Supreme Court affirmed the Court of Chancery’s decision.

To prevent trafficking in NOLs, IRS regulations (Section 382 of the Internal Revenue Code) reduce the value of NOLs following a change in ownership, defined in part by increases in ownership by 5 percent shareholders. To protect the value of its NOLs, Selectica put in place a poison pill threshold of 4.99 percent and limited additional share purchases by current 5 percent shareholders.

Professor Erickson testified on the nature of NOLs as valuable contingent assets. He also provided evidence of other companies taking actions similar to those of Selectica to preserve and realize the value of their NOLs. Professor Coates opined on the nature of poison pills, testifying as to the customs and practices of similarly situated companies, including those with NOL pills.
The court concluded that the adoption and implementation of the NOL pill were reasonable and proportionate responses to the threatened loss of NOL value and, as such, valid exercises of the board’s business judgment. The court noted: “Moreover, the 4.99% threshold for the NOL Pill was driven by our tax laws and regulations; the threshold, low as it is, was measured by reference to an external standard, one created neither by the Board nor by the Court. Within this context, it is not for the Court to second-guess the Board’s efforts to protect Selectica’s NOLs.”

In October 2010, the Delaware Supreme Court affirmed the Court of Chancery’s decision.