COXCASTLENICHOLSON

LITIGATION

CLIENT ALERT MARCH 2010

COX CASTLE & NICHOLSON LAWYERS SUCCESSFULLY DEFEND CORPORATION'S "POISON PILL" DESIGNED TO PROTECT NET OPERATING LOSSES

The Delaware Court of Chancery published an important decision in *Selectica Inc. v. Trilogy Inc. and Versata Enterprises.*, C.A. No. 4241-VCN (Feb. 26, 2010) last week that addresses the ability of a corporation to lower its "poison pill" trigger threshold to 4.99% to protect the tax benefits of accumulated net operating losses ("NOLs") rather than the more traditional protection against hostile take-overs of historically profitable companies. In this case, Selectica, a microcap company that had accumulated significant NOLs, amended its shareholder rights plan to lower the threshold in the face of an attempt by a shareholder-competitor to accumulate more than 5% of its stock, thereby threatening the future use of its NOLs. Section 382 of the Internal Revenue Code imposes limitations of the use of NOLs if a company experiences an "ownership change." An "ownership change" is generally determined by looking for a change of ownership of more than 50% of the company's stock by 5% or greater shareholders over a rolling three-year testing period.

After becoming aware that Trilogy was acquiring significant number of shares and that Selectica was approaching a Section 382 ownership change, the Selectica board reduced the trigger for its shareholder rights plan from 15% to 4.99% (just under the 5% threshold used for section 382 calculations). Selectica informed Trilogy of the new rights plan, but Trilogy nonetheless continued to buy shares and refused Selectica's overtures for a standstill, ultimately intentionally buying through the 4.99% threshold, triggering the pill. Trilogy's stated motive was to bring "urgency" to the resolution of unrelated disputes between the two companies. After Trilogy's continued refusal to assure Selectica it would not purchase additional shares, Selectica's board exercised the exchange provisions of the rights plan and diluted Trilogy's holdings from 6.7% to 3.3%. Selectica then sued for declaratory relief to uphold the board's actions. Trilogy counterclaimed, seeking invalidation of the actions on legal and equitable grounds, including the claim that the 4.99% trigger was *per se* invalid.

The decision represents a complete success for Selectica. In the first case addressing the intentional triggering of a modern "poison pill," the court determined that Selectica's adoption of the lower threshold was neither a coercive or a preclusive anti-takeover measure, but was reasonable given the impact that Trilogy's purchases might have had on the company's ability to use its NOLs in the future.

Cox Castle & Nicholson LLP lawyers, Jonathan S. Kitchen and Christian H. Cebrian, served as trial counsel to Selectica, Inc. along with Delaware counsel, Richards Layton & Finger. The case, involving a host of expert and lay witnesses, was brought to trial in just five months. The decision is important for many corporations in the current economic climate because it validates a tool increasingly being adopted by public companies of all sizes to protect their ability to offset past losses against potential future profits as the economy recovers.

If you have any questions regarding the Selectica case or your litigation needs in general, please do not hesitate to contact:

Jonathan S. Kitchen at 415.262.5168 or jkitchen@coxcastle.com

Christian H. Cebrian at 415.262.5123 or ccebrian@coxcastle.com