

November 6, 1986

To Our Clients

Basic Concept of Poison Pill
Substained in Second CTS Case

The Seventh Circuit Court of Appeals, in a second opinion by Judge Posner, has remanded to the district court the CTS poison pill for further consideration as to whether the procedure by which it was formulated and recommended for adoption met the requisite standards of reasonableness and good faith. This part of the opinion is another iteration of the warning that takeover defenses must be the subject of very careful and independently advised consideration by the target's directors.

The new CTS case is, however, of great significance, particularly in light of Judge Posner's express distaste for poison pills, with respect to the basic legal issues inherent in the structure of poison pills. The opinion holds that:

- (1) The basic concept of the poison pill is valid and legal under Indiana and Delaware law; the discrimination against a 20% or 30% or 50% shareholder present in all pills is a discrimination among shareholders, not among shares, and, therefore, not in violation of the statutory prohibition against discrimination among shares. This is directly contrary to Judge Broderick's decision in the NL case decided under New Jersey law and Judge Crabb's decision in Preway decided under Wisconsin law. It is an extremely important reaffirmation of the basic legality of poison pills established by the Supreme Court of Delaware in the Household and Revlon cases and hopefully will be instructive to other federal courts which have taken a more restrictive view of poison pills than the state courts.
- (2) State law permitting a poison pill does not violate the Commerce Clause of the Constitution and, as held in the Household case, there is no issue as to the constitutionality of poison pills.

At a time of frenzied takeover activity and mounting attacks on poison pills by corporate raiders, the SEC and institutional investors, Judge Posner's opinion in CTS is specially important and welcome.

M. Lipton