HUNTON& WILLIAMS

Client Alert

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Stockholder's Claim that Directors Should Have Adopted a Rights Plan is Time-Barred

On September 27, 2013, the Delaware Court of Chancery dismissed a stockholder's complaint alleging that a board of directors breached its fiduciary duties by failing to adopt a stockholder rights plan (also known as a "poison pill"). The plaintiff argued that a rights plan was necessary to prevent the corporation's largest stockholder from obtaining majority control through open-market purchases of the corporation's stock. The directors responded that they were prohibited from adopting a rights plan under an investment contract entered into with the stockholder when it initially invested in the company in 2009. The court dismissed the complaint, finding that it was time-barred because the three-year period for pursuing claims against the directors began to run in 2009 when the investment contract was executed.

Background

In 2009, Liberty Media Corporation ("Liberty") invested $530 million in Sirius XM Radio Inc. ("Sirius"). At the time, Sirius was "struggling" and its stock traded below $0.15 per share. In connection with its investment, Liberty entered into an investment agreement (the "Investment Agreement") with Sirius with a three-year standstill period during which Liberty agreed not to purchase additional Sirius stock. The Investment Agreement further provided, however, that Sirius would not adopt a stockholder rights plan or implement similar anti-takeover measures to prevent Liberty from increasing its ownership once the three-year standstill period expired.

In the years following Liberty's investment, Sirius's stock price rose over $2.00 per share. In 2012, when the standstill period expired, Liberty publicly announced its intent to acquire majority voting control of Sirius through open-market purchases of Sirius stock. According to the court, even though the Sirius board of directors did not want Liberty to obtain control without paying a control premium, it "did not attempt to have the [anti-takeover covenants] invalidated and did not implement a poison pill to block Liberty Media from taking majority control, because it viewed itself as bound by the Investment Agreement." In January 2013, Liberty announced that it had received all required regulatory approvals and acquired a majority of Sirius's outstanding stock. During this period, a Sirius stockholder brought suit alleging that the directors breached their fiduciary duties by not adopting a rights plan to prevent Liberty's "creeping takeover."

Court's Decision

Chancellor Leo E. Strine, Jr., held that the plaintiff's complaint was time-barred. Under Delaware law, claims for breach of fiduciary duty generally must be brought within three years. Here, the court held that the challenged action — that is, the board's decision "to take Liberty Media's capital" and agreement "not to adopt a poison pill or any other anti-takeover measures against Liberty Media after the standstill period expired" — was made in 2009. The court also held that there were no grounds to toll the three-year period. As a result, the complaint was not timely filed.

The court also rejected the plaintiff's claim that Liberty, as Sirius's de facto controlling stockholder, owed a duty to negotiate with the board of directors in obtaining control. It noted that such an argument would require Liberty to relinquish its contractual right. The court also noted that the plaintiff failed to plead that

Liberty used its control of the Sirius board of directors through its board representatives, otherwise misused any Sirius resources, or was in possession of material nonpublic information in making the open-market purchases.

The *Sirius* court expressly stated that it was not reaching the merits of whether Sirius's board of directors breached its fiduciary duties. Still, the case raises interesting issues, including the extent to which a board of directors can contract away its ability to adopt takeover defenses. On that issue, it bears noting that in *Unisuper Ltd. v. News Corp.*, 2005 WL 3529317 (Del. Ch. Dec. 20, 2005), the Court of Chancery refused to dismiss claims challenging a board's decision to extend a rights plan in violation of a previously announced board policy. There is also little guidance as to how courts might apply *Revlon* duties when a board of directors approves a transaction that could result in a change of control in the future. A similar fact pattern to *Sirius* came before Chancellor Strine in *Hokanson v. Petty*, 2008 WL 5169633 (Del. Ch. Dec. 10, 2008). There, a distressed company approved an option allowing a stockholder to acquire the company at a later time at a preset formula. Like *Sirius*, however, the challenge in *Hokanson* was dismissed as time-barred.

Another underlying issue is the extent to which a board of directors must take affirmative steps to prevent a third party from acquiring control of a company. In *Louisiana Municipal Police Employees Retirement System v. Fertitta*, C.A. No. 4339-VCL, mem. op. (Del. Ch. July 28, 2009), the Court of Chancery found that a board of directors likely breached its fiduciary duties when, among other things, its chief executive officer acquired majority voting control of the company through open-market purchases. The court stated, however, that "there is no *per se* duty to employ a poison pill to block a 46% stockholder from engaging in a creeping takeover" and that the defendants had also engaged in "other suspect conduct" that supported "a reasonable inference at the motion to dismiss stage that the board breached its duty of loyalty in permitting the creeping takeover." As noted above, the *Sirius* court did not rule on this issue.

Contact

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