

THE M&A TAX REPORT

The Monthly Review of Taxes, Trends & Techniques

Volume 2, Number 3

October 1993



TAX INSTITUTE
Editor-in-Chief

Robert W. Wood
San Francisco

Managing Editor

Lesli S. Laffie, LL.M.
W. New York

Advisory Board

Gilbert D. Bloom
KPMG Peat Marwick
Washington

Louis S. Freeman
Sonnenschein, Nath
& Rosenthal
Chicago

Elliot G. Freier
Irell & Manella
Los Angeles

Lawrence B. Gibbs
Johnson & Gibbs
Washington

Steven K. Matthias
Deloitte & Touche
San Francisco

Matthew A. Rosen
Skadden, Arps, Slate,
Meagher & Flom
New York

Irving Salem
Latham & Watkins
New York

Joseph L. Schiffhouer
Federal Express Corp.
Memphis

Mark J. Silverman
Steptoe & Johnson
Washington

Robert Willens
Lehman Brothers
New York

Like Soda for Chocolate: Dr. Pepper Poison Pill Plan Fights Cadbury

by Robert W. Wood • San Francisco

Poison pill plans are in the news again, with the adoption by Dr. Pepper/Seven Up Cos. of a plan designed to force Cadbury to pay additional amounts for any takeover attempt it makes of the soft-drink maker, which is the country's third largest. Cadbury, which holds 25.9% of the stock, is already Dr. Pepper's largest shareholder. The poison pill would be triggered if Cadbury increases its holdings to 26% or more, and would give all shareholders except Cadbury the right to acquire Dr. Pepper common shares at a 50% discount. As is typical, the poison pill provision is not triggered if Dr. Pepper's board approves a tender or exchange offer that is in the "best interests" of the company. (See "Dr. Pepper Adopts 'Poison Pill' Plan Against Cadbury," *Wall St. J.*, 9/3/93, p. B7.)

Plan Specifics

Under the plan, the company would issue to existing stockholders a right to buy one one-thousandth of a share of a new preferred stock for each share held. The exercise price would be \$90, and each one one-thousandth of a share of preferred essentially would equal one share of common. The rights generally would be triggered ten days after either the public announcement that a person or group acquired 10% of the company's

voting stock, or after the beginning of a tender offer to acquire 10% or more. In Cadbury's case, as previously mentioned, the threshold would be 26%.

The rights would then become rights to buy common stock at a 50% discount, and the rights held by the party that made the stock purchase would become void. Furthermore, if Dr. Pepper was merged, or if at least 50% of its assets or earning power were sold, the rights would convert to rights to purchase the acquirer's common stock at a 50% discount.

Tax Issues

Revenue Ruling 90-11, 1990-1 CB 10, addressed the tax status of pill plans, concluding that contingent rights

Continued on Page 2

ALSO IN THIS ISSUE:

- Uniroyal (and Other) Buyouts: Revisiting the Step-Transaction Doctrine3
- Current Problems and Possibilities**4
- Harcourt, Cyanamid, Ethyl Contemplate Spins6
- Rulings Address Dividend Treatment of Boot in Reorgs.7
- Macy's Gets a Bargain from IRS.....8

LIKE SODA FOR CHOCOLATE Continued From Page 1

awarded under such plans do not constitute income because the plans are contingent on a tender offer or acquisition. Unfortunately, the ruling states that it does not address the status of pill plans in general, but only the *specific* plan described in the ruling, or a plan that is "similar" to the rights plan described in the ruling. Rights are similar if the principal purpose for adopting the plan is to establish a mechanism by which a publicly held corporation can provide shareholders with rights to purchase stock at substantially less than fair market value as a means of responding to unsolicited offers to acquire the corporation.

How does the Dr. Pepper pill plan compare to the standards set out in the ruling? The requirement that the principal purpose of the plan must be to provide rights to public shareholders to buy stock at a discount as a means of defeating a hostile bid should be fairly easy to satisfy.

Another requirement might be more difficult to meet, though. For example, it is not clear how important it is that the adopting company have the right to "pull the plug" on the pill rights. In the ruling, the adopting company had such a right. The termination rights were exercisable by the company for a limited number of days even after the rights were issued (pursuant to one of several specified triggering events). As the price for exercising this termination right, the company would have to make a small cash payment to the rights holders, effectively curtailing their ability to acquire additional stock for a bargain price.

In Dr. Pepper's case, the determination by the board that the tender or exchange is in the best interests of the company would prevent the pill

from being triggered, but that is hardly the same as pulling the plug on rights once already issued. Ultimately, it seems unlikely that the IRS would want to take the position that the mere issuance of rights constitutes income. Still, companies adopting pill plans either will have to convince themselves that their plans are quite close to the facts of *Rev. Rul. 90-11* or other guidance, seek a ruling, or take their chances.

Raising the Price

In any case, the pill plan obviously raises the price of an acquisition. Dr. Pepper has already been sued by shareholders seeking to rescind the plan. Plus, Cadbury will acquire a big share of the drink market with its announced acquisition of A&W Brands. (See "Cadbury to Buy A&W Brands For \$334 Million," *Wall St. J.*, 9/10/93, p. A12.) ■

The M&A Tax Report is published monthly by Tax Institute, P.O. Box 192026, San Francisco, CA 94119, Tel. 415-566-5111 or 1-800-852-5515, Fax 415-566-7310. Copyright © 1993 by Tax Institute. All rights reserved. No part of this newsletter may be reproduced in any form by microfilm, xerography, or otherwise, or incorporated into any information retrieval system, without the written permission of the copyright owner. Reprints of current and past articles are available. Inquiries regarding reprints and permissions should be addressed to Reprint Editor, Tax Institute, P.O. Box 192026, San Francisco, CA 94119.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that neither the publisher nor the authors are engaged in rendering financial, legal, accounting, tax, or other professional service. If financial, legal, accounting tax, or other expert assistance is required, the services of a competent professional should be sought. Subscription price: USA, U.S. possessions and Canada—\$245 annually; elsewhere—\$295 annually. Direct editorial and subscription inquiries to Tax Institute, P.O. Box 192026, San Francisco, CA 94119.