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BLOG

Is Now the Time for Companies to Adopt a Shareholder Rights Plan?

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As the COVID-19 pandemic continues to depress stock prices, investment bankers have begun to recommend that public companies consider adopting shareholder rights plans to prevent strategic buyers and private equity firms from being able to acquire them on the cheap—*i.e.*, at prices that do not reflect their long-term intrinsic value. The primary countervailing consideration—and the reason that the number of shareholder rights plans has declined tenfold over the last 20 years—is that shareholder advisory firms such as Institutional Shareholder Services (ISS) have threatened to recommend that shareholders withhold votes for directors who serve on companies that have adopted shareholder rights plans that don't meet specific requirements. As a result, many public companies are now faced with a conflict between the advice of respected investment banks and the ongoing specter that the adoption of a shareholder rights plan will result in a lowering of their governance ratings and essentially votes against their directors.

In a nutshell, a shareholder rights plan, sometimes referred to as a "poison pill," deters bidders from making takeover bids without the support of the board of directors by threatening these bidders with the prospect of massive dilution of their common stock positions if they exceed a certain ownership threshold. Typically, a shareholder rights plan takes the form of the issuance of interests in preferred stock that, when a bidder buys target stock in excess of a specified threshold (usually, 10%-15%), allow all holders except the bidder to buy the company's common stock at half-price unless before crossing the threshold the bidder has won the support of the board of directors for its bid or other plans for the company.

If a company believes that a decline in its stock price has rendered its shareholders vulnerable to low-ball bids, it should consider adopting a shareholder rights plan. Ordinarily, the decision to adopt a shareholder rights plan can be a fraught decision because it can attract unwanted attention from investors and adverse voting recommendations from ISS. Many believe, however, that the dramatic across-the-board decline in stock prices tends to deflect the adverse attention that ordinarily follows the adoption of a shareholder rights plan. We also note that on April 8, 2020, ISS issued policy guidance, "Impacts of the COVID-19 Pandemic," which stated, "A severe stock price decline as a result of the COVID-19 pandemic is likely to be considered valid justification in most cases for adopting a pill of less than one year in duration; however, boards should provide detailed disclosure regarding their choice of duration, or on any decisions to delay or avoid putting plans to a shareholder vote beyond that period." Ultimately, of course, boards of directors must do what they feel is right for their shareholders.

Because of the recent stock price declines, more companies adopted shareholder rights plans in March 2020 than in any other month in recent years. The companies that adopted them engage in a variety of industries. Below are the high points of the recently adopted shareholder rights plans:

1. Of the shareholder rights plans adopted during the market volatility resulting from the COVID-19 pandemic, many had a triggering ownership threshold of 10% of the shares outstanding, and at least six had rights plans of slightly less than 5%.

2. The expiration date of the recently adopted shareholder rights plans was generally less than a year. ISS takes the position that these shorter-term pills (those with a duration of less than one year) are subject to its case-by-case evaluation and are not automatically subject to its general policy to recommend "withhold" votes for directors of companies that have adopted pills. The terms of pills that assuredly will not result in a negative voting recommendation are generally considered not to be effective for the essential purpose of deterring inadequate takeover bids because, among other things, the triggering threshold is set at 20% of the outstanding beneficial ownership, far higher than the prevailing threshold of recently adopted shareholder rights plans.

   We would note that on April 8, 2020, *The Wall Street Journal* reported that ISS issued a recommendation that shareholders of the Williams Cos., a company that recently adopted a rights plan with a 5% threshold, withhold their votes for Williams' chairman of the board, but cast a "cautionary" vote for the election of Williams' other directors. In reaching this recommendation, ISS noted that the 5% threshold in the Williams plan was "highly restrictive."

3. Companies considering the adoption of a shareholder rights plan should make sure they include the latest developments in shareholder rights plan technology. For example, in the last couple of years, provisions targeting groups of activists working in concert, if not by express agreement (so-called "wolf pack" provisions) and provisions triggered by derivative ownership, have become more prevalent.

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