

CORONAVIRUS RESOURCE CENTER

Rethinking Poison Pills, Again

April 9, 2020

The significant decline in public company equity values stemming from the COVID-19 crisis has, as in previous economic crises, raised the specter of opportunistic behavior. Well-capitalized investors may take advantage of depressed prices to acquire stakes in or launch unsolicited offers for temporarily undervalued companies. This risk has led numerous public company boards to reconsider the usefulness of stockholder rights plans, commonly known as poison pills.

Poison pills are one of the more powerful tools a board can deploy to limit undesired accumulations of a company's shares. In recent years, however, pills have gone out of fashion. At the end of 2009, 346 companies in the S&P Composite 1500 index had stockholder rights plans in place, while only 25 had such plans at the end of 2019. Since the February market peak, however, nearly two dozen public companies have adopted stockholder rights plans, either as a prophylactic measure or in response to a specific threat. Most of these companies operate in industries experiencing precipitous deteriorations in demand during the COVID-19 pandemic, such as energy, retail, transportation, and entertainment. These companies have seen their market capitalizations drop to levels that place them in a potentially vulnerable position.

The decline in stockholder rights plans over the prior decade resulted from several factors, including:

- the strong view of many institutional stockholders, supported by proxy voting advisors, that poison pills are generally not in the stockholders' best interests;
- the relative paucity of overtly hostile deals; and

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- the recognition by boards that companies can achieve much of the benefit of a rights plan by having one “on the shelf,” ready for immediate adoption if and when needed, rather than continuously in place irrespective of any specific threat.

The two most prominent proxy voting advisors, ISS and Glass Lewis, will in general recommend that shareholders vote against directors who approve the adoption of a rights plan without shareholders’ approval unless, among other things, the plan expires in less than one year, is put to a shareholder vote or, subject to specific requirements, is designed principally to protect net operating losses carryforwards. In its Policy Guidance on the “Impacts of the Covid-19 Pandemic” issued on April 8, 2020, while ISS confirmed that it will continue to apply the same general guidelines and case-by-case approach in reviewing poison pills, it also signaled that, with appropriate disclosure, 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. The majority of the pills adopted in March and April of this year expire in less than one year (typically 364 days after adoption) and are triggered by acquisitions in the range of 10-15% of the company’s equity. The rights plan adopted by Williams Companies is an outlier, with a 5% threshold. This reportedly caused ISS to classify the pill as “highly restrictive” and to recommend against the election of the company’s Chairman at the company’s upcoming stockholder meeting. [Exhibit A](#) sets forth certain key features of a number of recently adopted pills.

In considering whether to adopt a stockholder rights plan in the current environment, boards should consider the following:

- What signal will be sent to stockholders by adopting a pill? Will it be received as a message of resolve against the threat of an opportunistic action, or as a sign of vulnerability?
- To what extent does the company have other protections against unwanted share accumulations? For example, for regulated businesses such as banks and insurance companies, acquisitions of equity interests above specified thresholds generally require approval by applicable regulators. Most if not all states, including Delaware, have business combination statutes that limit an acquirer’s ability to effect a business combination without target company board approval.
- Are there methods available to the company to alert it to possible hostile activity so that it can quickly adopt a pill in time to stave off an attack? Normally, companies would rely on (i) the Hart-Scott-Rodino antitrust notification rules and (ii) the share acquisition reporting rules under the federal securities laws. These, however, are imperfect early warning systems.

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- HSR generally calls for a 30-day waiting period before an investor can acquire shares with a value in excess of \$94 million—which period cannot begin until the company makes its own filing. Once alerted, the company can adopt a pill prior to the expiration of the waiting period. However, investors can sometimes avoid HSR filing requirements through the use of derivatives or by claiming applicability of the passive investor exception. Moreover, in the current market environment, \$94 million can represent a significantly larger portion of the company's equity than would be the case in normal times.
 - Federal securities laws require a non-passive investor acquiring beneficial ownership of more than 5% in a public company to file a Schedule 13D with the SEC within 10 days after crossing such threshold, although the investor can continue to accumulate shares during that 10-day period. Here too, derivative positions can be used to obscure the accumulation of large equity positions.
 - Given current circumstances, is the threat of an adverse recommendation by proxy voting advisors less of a concern?
 - Which specific terms should the pill contemplate to reflect the current threat? As shown in [Exhibit A](#), recently adopted pills are structured with shorter sunset dates and low trigger thresholds to reflect the expected relatively short-term nature of the COVID-19 threat. Several other features, however, must be considered, such as grandfathering based on the company's current stockholder base and provisions allowing qualifying offers to be submitted directly to stockholders. Ultimately, the specific design of a pill should be tailored to the type of threat perceived by the company.

The courts of Delaware have made clear that the decision of the board to adopt a stockholder rights plan on a “clear day”—i.e., in the absence of any specific threat—is protected so long as the board reasonably perceives a threat from the possibility of hostile actions. Decisions to adopt a pill in response to a specific threat, or whether to redeem a pill, will be reviewed based on the specific threat posed.

In any event, boards need to be attuned to the views of their stockholders and prepared for resistance from proxy voting advisors should they decide to adopt a stockholder rights plan. Like any significant corporate decision, the adoption of a poison pill should be accompanied by a considered stockholder communication plan, including direct outreach to the company's important stockholders. The reasons for the pill should be clearly communicated, as should the intention of the board to continue to evaluate its necessity, as well as other steps to protect the company's stockholders from opportunistic behavior.

Exhibit A – Selected Recent Stockholder Rights Plans

Company	Rights Plan Date	Likely Underlying Reason	Trigger	Sunset Date
Hexcel Corporation	April 6, 2020	Prophylactic*	15%	April 20, 2021
Woodward	April 6, 2020	Prophylactic*	15%	April 5, 2021
Commvault Systems	April 3, 2020	Response to specific threat	10% (or 20% if passive institutional investor)	April 1, 2021
Chico's FAS	April 2, 2020	Prophylactic**	10% (or 20% if passive institutional investor)	April 1, 2021
Six Flags Entertainment	March 31, 2020	Prophylactic***	10% (or 20% if passive institutional investor)	March 30, 2021
Synalloy Corporation	March 31, 2020	Response to specific threat	15%	March 31, 2021
Tailored Brands	March 30, 2020	Response to specific threat	10% (or 20% if passive institutional investor)	March 29, 2021
Spirit Airlines	March 29, 2020	Prophylactic	10% (not applicable to passive institutional investor)	March 29, 2021
AAR Corp.	March 27, 2020	Prophylactic	10% (or 20% if passive institutional investor)	February 28, 2021
Fluor Corporation	March 24, 2020	Response to specific threat	10%	December 31, 2020
Delek US Holdings	March 20, 2020	Response to specific threat	15%	March 19, 2021
Williams Companies	March 19, 2020	Prophylactic	5% (not applicable to passive institutional investor)	March 20, 2021
Global Eagle Entertainment	March 19, 2020	Prophylactic	20%	December 31, 2020
Dave & Buster's	March 18, 2020	Response to specific threat	15% (or 20% if passive institutional investor)	March 17, 2021
Occidental Petroleum	March 12, 2020	Response to specific threat	15% (or 20% if passive institutional investor)	March 11, 2021

* Recently terminated proposed Hexcel-Woodward merger.

** Rejected an unsolicited acquisition proposal late in 2019.

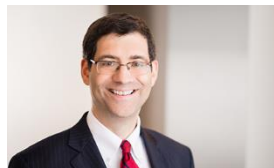
*** Activist investor entered into a Cooperation Agreement with the company early in 2020.

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Please do not hesitate to contact us with any questions.

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