Rise of the aggressive poison pill

Corporate Alert
COVID-19 Alert
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I. Background

The general purpose of a shareholder rights plan or “poison pill” is to deter and mitigate the time pressures of non-negotiated, hostile takeover attempts made at unfair or inadequate prices, or by coercive or unfair tactics. Rights plans have been around for quite some time. Rights plans generally give the adopting corporation’s stockholders (excluding the potential acquiror) the right to purchase stock at a nominal price, triggered by the acquirer’s acquisition of beneficial ownership of a specified percentage of the corporation’s stock. This right is typically applicable to stock in the corporation prior to the proposed business combination, or in the final corporation after a successful hostile takeover.

There is, however, no one-size-fits-all rights plan and it is incumbent upon a board that is considering the adoption of a rights plan (including the adoption of a rights plan that was previously “on the shelf”) to receive input from its advisors concerning the current state of the market with respect to key features of the plan. There are several design features that allow a board to customize its rights plan to take into account, among other matters, prevailing market conditions and particular facts and circumstances applicable to the corporation. In the next section, we provide a brief discussion of some of the key levers available to a board that are currently being discussed in virtual boardrooms. In the third section, we provide additional details about the changes to these levers that we are observing.[1]

II. Key rights plan levers for board consideration

Trigger

Rights plans achieve their objective by conferring certain rights on the corporation’s stockholders that have the effect of imposing substantial, disproportionate financial and voting dilution on a potential activist. Determining the thresholds at which certain provisions of a rights plan are activated is a key decision that a board needs to make.

Two-tier trigger

The purpose of this measure is to restrict further accumulations by activists while leaving the door open for passive investors. In Delaware, the validity of a two-tiered pill was upheld by the Delaware Court of Chancery in Third Point LLC v. Ruprecht, which imposed a 10 percent trigger threshold on Schedule 13D filers and a 20 percent trigger threshold on Schedule 13G filers. Adopting such a provisions in other states requires additional analysis.

[1] DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as
Derivative trigger

The purpose of this measure is to prevent activists from accumulating stock positions under the radar in excess of the trigger threshold. In order to combat this threat, certain synthetic interests in securities created by derivative positions – whether or not such interests are considered to be ownership of underlying shares of common stock or are reportable for purposes of Regulation 13D of the Securities Exchange Act of 1934, as amended – are treated as beneficial ownership of the number of shares of common stock equivalent to the economic exposure created by the derivative positions.

Acting in concert

The purpose of this measure is to prevent stockholders (particularly hedge funds) from cooperating, or acting in coordination, with each other in ways that fall short of an “agreement, arrangement or understanding,” and forming a “group,” but still effectively allowing the stockholders to act in a coordinated manner with other large block holders (an informal “wolf pack”). Boards considering this avenue typically include language that expands upon the definition of “stockholders acting in concert” under the rights plan.

Flip-in/flip-over provision

Flip-in trigger

The purpose of this measure is to entitle the eligible right-holders (i.e., all stockholders other than the potential acquiror) to purchase the corporation’s equity securities at a substantial discount.

Flip-over trigger

The purpose of this measure is to obligate an acquiror to honor the redemption or conversion provisions of the rights plan in the event of a merger or other consolidation. The term usually refers to a conversion provision that allows the right-holder to acquire voting equity securities of the acquiror at a substantial discount.

Exchange feature

The purpose of this measure is to afford flexibility by providing a corporation with additional time to distribute rights certificates without reducing the rights plan’s immediate dilutive effect. A common way to do this is to include features that extend the timeline for distributing right certificates or allow independently managed trusts to exercise the rights of stockholders until the right certificates are distributed.

III. Current market conditions and plan features

The market dislocation caused by the coronavirus disease 2019 (COVID-19) pandemic has led to significant declines in equity values of US companies across industries. Therefore, it should come as no surprise that we have seen an increase in interest in rights plans, whether formally adopted or available on the shelf.

The terms of rights plans vary over time, and the terms of the rights plans currently being discussed in boardrooms and that have been formally adopted and announced are more aggressive in some regards. Almost all formally adopted plans have terms that expire within one year, so their adoption did not require stockholder approval. For ease of discussion, the remainder of this alert excludes active NOL plans (which represented 77 out of 160 active rights plans as of December 31, 2019).

Historical snapshot

For the past few years, rights plans have increasingly come under attack by prominent shareholder advisory services, and the number of companies with active rights plans has declined. As of December 31, 2019, there were only 160 US companies with an active rights plan.

Volume of adoptions in March 2020

During March 2020, there were 22 adoptions (17 traditional and 5 NOL) by US companies. To put this in context, the number of traditional rights plans adopted by US companies in March was more than five times the number of traditional rights plans adopted in any single month since January 2017. The previous high since January 2017 was three, which occurred seven times in this period.

Characteristics of these newly adopted traditional rights plans and the various utilized measures are reflected below and compared to the 83 traditional rights plans of US companies that were active as of December 31, 2019:
The rights plans adopted in March contain on the whole more aggressive measures than active rights plans in place as of December 31, 2019:

- 59 percent (10 of 17) of March plans utilize a two-tier trigger, up from 9 percent (8 of 83) of December plans;
- 100 percent of March plans include a derivative trigger, up from 51 percent (42 of 83) of December plans;
- 35 percent (6 of 17) March plans include “Acting in Concert” language, up from 16 percent (13 of 83) of December plans; and
- 6 percent (1 of 17) March plans includes a 5 percent ownership trigger which is uniquely low.

**Preemptive announcement of advisory teams**

A common practice of public companies when faced with a potential hostile acquiror or activist investor is to assemble a focused and experienced advisory team to assist and advise the corporation’s board of directors and management. These teams typically include appropriate insiders as well as third party advisors such as investment bankers, outside legal counsel, public relations and proxy solicitation firms among others.

In March, several companies included mention of its third party advisors in the press release announcing the adoption of a rights plan. The inclusion of the advisors’ names in the press release, even in the absence of a known threat, informs the market that the company has an team engaged and is “ready to go” should it be needed.

As public companies review their available defensive measures, we encourage them to remain mindful of the availability of a rights plan and current market trends on their adoption and terms.

If you have questions about issues raised in this publication, please contact the authors or a member of DLA Piper’s Corporate or Public Company practices.

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[1] The data and chart used in this alert are derived from Deal Point Data as of April 6, 2020.

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