

Should companies play strong defense in these hostile times?

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Extreme dislocation and a major sell-off in global equity markets have led to many public companies finding their stock prices at severely depressed levels, often over 50% off last twelve month highs.

While most companies and investors are in crisis management mode, these markets may nevertheless present attractive opportunities for strategic or financial bidders. Moreover, we expect that campaigns from well-known activists will continue at a reasonable pace in the current market.

Many companies prepare for the possibility of a hostile campaign by having a shareholder rights plan (often called a “poison pill”) “on the shelf” and ready for adoption if needed. In normal market conditions, companies mostly leave their rights plan “on the shelf” and don’t adopt until an actual threat arises.

The current dislocation gives rise to the question of whether the conventional playbook makes sense. For many it does. However, these times are different in that:

- The market dislocation may allow for rapid accumulation of positions at materially depressed prices.
- The company and its shareholders may not get timely and complete notice of stock positions. HSR or Schedule 13 filings have built-in gaps and delays, and potential bidders or activists may use derivative positions that would not be disclosed.
- A meaningful stock position can have a disproportionate impact given the large positions held by passive index funds.
- An opportunistic party may therefore be able to achieve a position of substantial influence or control without paying a control premium to other shareholders, with the result that “the horse may be out the barn” before a rights plan could be adopted.

In considering whether to adopt a rights plan before an actual threat emerges, a Board will want to consider:

- The over-arching question of whether such an action is in the best interests of its shareholders in light of the company’s situation.
- How that logic will be communicated to its shareholders.
- How that logic will be communicated to ISS and other proxy advisory firms.
- That adopting a rights plan before a threat arises will be protected by the business judgment rule.
- The appropriate terms of the rights plan tailored to the current extenuating circumstances:
 - Percentage trigger threshold. Most plans are at 15%, but a meaningfully lower threshold may be appropriate now.
 - Duration.
 - Scope of derivatives to be covered.
 - Exemption for passive (including 13G) investors.

The reality is that adopting a rights plan will draw scrutiny and some criticism. However, Boards understand that their role is to be protectors of the long-term best interests of the shareholders and should consider what actions may be appropriate in that light and given the company’s particular circumstances.

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