

US: It's time to reconsider poison pill strategies

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Unprecedented times

- The current environment creates significant vulnerability for many public companies.
- In many cases, stock prices have dropped to historical lows.
- The defensive profile of many public companies has eroded over time under pressure from ISS, Glass Lewis and activist investors.
- Shareholder rights plans, or poison pills as they are common called, are arguably the single most effective defense mechanism companies can adopt.

Conditions are ripe to consider a poison pill

- Many companies' stock prices have dropped rapidly and significantly due to COVID-19 and energy prices.
- When stock prices drop for reasons unrelated to company fundamentals, those companies are vulnerable to opportunistic activists and potential unsolicited acquirors, who can otherwise acquire a large stake before filing a Schedule 13D or 13G or HSR Form.
- It is likely that COVID-19 and other current conditions are “relatively” short-term events and, thus, many companies' share prices will rebound over time.
- That means companies need to consider measures to protect their shareholders to enable them to benefit from the return to more normal share prices.
- The CARES Act has provided for enhanced NOL carryback opportunities for some companies increasing the need to protect NOL assets.
- In fact, 2020 has already seen a significant uptick in preemptive standard and NOL pill adoption.

What is a poison pill?

A poison pill:

- Deters unauthorized accumulation of shares by imposing substantial dilution upon any shareholder that acquires more than a specified amount of shares (usually 10-20 percent) without board approval.
- Allows management time to negotiate the best possible return for existing shareholders or, if no acceptable offer is received, to just say 'no' to an activist takeover.
- Is designed to avoid interference with day-to-day operations of the company.
- Is a mechanism that has been around for decades and has been upheld as valid by many courts.
- Can also be used to protect the value of NOLs that could be lost due to activist activity, in which case the threshold trigger is often much lower (~4.9 percent).



Key customizable terms

- **Term:** Many poison pills today expire within one year and some contain renewal options requiring shareholder approval.
- **Threshold:** The amount of share ownership that triggers a poison pill can be set based on a company's specific needs (typically 10-20 percent for standard pills and ~4.9 percent of NOL pills) and may contain two-tier triggers allowing passive investors to acquire more shares than activist investors. Swaps and derivatives can also be addressed to prevent the use of these derivatives to avoid the threshold.
- **Wolf Packs:** Poison pills can contain language preventing shareholders from acting in concert to acquire large blocks to try to get around the threshold.
- **Grandfather Clause:** Existing shareholders can be excluded from the threshold or be subject to a separate threshold.

Sounds too good to be true: Considerations

- ISS, Glass Lewis and certain institutional investors generally oppose proactively-adopted pills (and the boards that adopt them) as a matter of policy, but will consider on a case-by-case basis poison pills that expire or go to a shareholder vote within 12 months.
- Poison pills may be viewed by activists and others as a “management entrenchment” strategy.
- They will not deter all cash offers for the entire company or proxy contests.
- Poison pills may increase the threat of proxy fights or lawsuits from activists.

Next steps

- Continue to monitor the overall shareholder base, tracking recent accumulations or unusual trading patterns, and engaging with key shareholders.
- Consider evaluating all of the company's existing and available defensive measures, including a poison pill.
- Consider designing a poison pill appropriate to the company and its current circumstances and preparing a pill to be put "on the shelf" so it can be rapidly adopted should circumstances warrant it.
- Consider adopting a short-term pill in order to protect the company against opportunistic activists and to provide existing shareholders with the opportunity to participate in a recovery of stock prices after the current circumstances pass.



Contact us if you have questions



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