

UPDATES

Sidley's Shareholder Activism Review – Tales From the Trenches –

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ISS Signals More Understanding for Poison Pills and Skepticism for Activist Campaigns During the COVID-19 Crisis

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In the midst of the COVID-19 pandemic, shareholder rights plans or “poison pills” continue to be a hot topic in Corporate America. As explained in our previous Sidley Update ([Should Boards Adopt a Poison Pill in the COVID-19 Crisis?](#)), the combination of high trading volumes and extreme levels of market volatility, along with the use of derivatives, makes it difficult for stock watch services to detect rapid stock accumulations. These factors make it easy for activists and hostile bidders to scoop up large stakes undetected at a time when most companies’ share prices are severely depressed as a result of the recent stock market crash. In response to these extraordinary circumstances, many companies are considering adopting a poison pill to establish a ceiling on share ownership (typically 10 percent or 15 percent for “regular” poison pills and 4.9 percent for rights plans adopted to protect tax net operating losses (NOLs)). In fact, since March 1, 2020, at least 28 U.S. public companies have adopted a poison pill, the highest number of new adoptions in such a short time period in over 20 years. To further put this number in perspective, only 25 S&P 1500 companies had a poison pill in place at the end of 2019 (Source: FactSet).

In ordinary times, we typically advise companies to refrain from adopting a poison pill in the absence of a specific activist or takeover threat and instead keep it “on the shelf” (i.e., fully drafted and ready for adoption). That is because ISS, Glass Lewis and many institutional investors generally frown upon the adoption of poison pills in the absence of such a specific threat. What was unclear until ISS issued new guidance yesterday was whether the proxy advisory firms would consider market conditions due to the COVID-19 pandemic the type of threat that may justify the adoption of a poison pill.

As we hoped, it appears that at least ISS understands why the adoption of poison pills may be warranted in these unprecedented times. In its new guidance issued on April 8, ISS reiterated that it would consider situations on a case-by-case basis, but it noted:

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. The triggers for such plans will

continue to be closely assessed within the context of the rationale provided and the length of the plan adopted, among other factors.

This is not inconsistent with ISS' April 3 recommendation to vote against the chairman of The Williams Companies, Inc. This recommendation clearly resulted from the board's adoption of a poison pill with a 5 percent trigger threshold where the poison pill was not designed to protect the company's NOLs.

Referring to the threshold, ISS noted:

Excluding NOL pills, 5 percent triggers are extremely rare since they are highly restrictive and could negatively impact the market for the company's shares as the market recovers. [...] When ISS asked the company whether it had considered adopting a more standard pill with a higher trigger and using its upcoming annual meeting to seek shareholder ratification of its 5 percent plan, the answer appeared to be "no."

Consequently, we expect ISS not to penalize boards that adopt short-duration poison pills (i.e., with a term of less than a year) in response to a steep share price decline as long as the remaining terms are justified, particularly the trigger threshold. Having said that, the new ISS guidance does not mean that every public company should adopt a poison pill in the current environment. As more fully explained in our previous Sidley Update (referenced above), in determining whether to adopt a poison pill, a board should consider various factors, including the company's existing takeover defenses, industry, market capitalization, trading volume, relative value compared to peers, shareholder base, debt change-in-control triggers and the amount of its NOLs (if any) as well as the existence of any potential hostile bidder or known activist.

As we have stated before, if a board decides, in accordance with its fiduciary duties under applicable law, to adopt a poison pill, it needs to communicate clearly the rationale for adoption, and the rationale for any terms that are outside the norm, to all constituencies, including ISS, other proxy advisory firms and institutional investors. In this context, ISS commented:

The challenge for investors will be to distinguish between pills that are justifiably adopted to protect against opportunistic bidders or short-term-focused activists and pills that overstay their stated purpose, helping to entrench boards and management teams that fail to navigate the crisis ahead, and consequently get left behind during the market's eventual recovery.

Lastly, ISS elaborated on its approach to proxy contests during the COVID-19 crisis. In its note, it appears to encourage activists to think twice about proceeding with a fight, particularly in cases where the urgency is not apparent:

There seems to be little doubt, for instance, that certain activist demands, like leveraged buybacks, could be seen as far less compelling this spring. ... For now, the activists who decide to forge ahead with their campaigns will most likely be labeled by corporations as opportunistic or unreasonable. In certain cases, that will not be an unfair characterization.

The implicit rationale behind its new guidance appears to be that ISS recognizes its greater social responsibility during the current humanitarian and economic crisis. ISS seems reluctant to distract boards and management teams at a time when they need to be laser focused on managing through the crisis and saving the livelihoods of millions of Americans. Activists are well advised to think twice before launching or escalating a campaign during these unprecedented times unless they can articulate an

urgent need to address a case of egregious corporate malfeasance.

Sidley Ranked No. 1 by FactSet for Activism Defense in Q1 2020

Sidley was ranked No. 1 among legal advisers for activism defense for Q1 2020 by number of campaigns, according to data provided by FactSet.

This new ranking confirms Sidley's position as a leading defender of Corporate America. Since 2016, Kai Liekefett and Derek Zaba, co-leaders of Sidley's shareholder activism practice, have defended against more than 55 proxy contests (while losing only three votes) and represented companies in more than 30 settlement agreements.

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