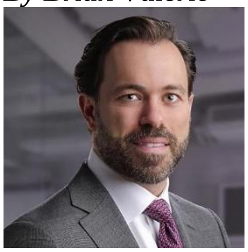
THE ADVISOR

Alliance™ ADVISORS

Adopting a Poison Pill is Not the Cure for the Coronavirus

By Brian Valerio

April 2020



Background

Capital markets have dropped precipitously since the coronavirus outbreak reached the U.S. in late February. Despite this tremendous drop, we are in the midst of a recovery that is premised on the belief that Congress' stimulus will boost U.S. consumer spending while also providing small businesses and companies with financial assistance to continue their operations. The recovery also hinges on the newfound belief that U.S. workers will return to work in the near future. If the stimulus fails to achieve its goals or the workforce is unable to return as quickly as hoped, the recent uptick may be short-lived. This is exemplified by the recent volatility in the markets.

The sudden drop led many companies' stock to plummet to a level that does not reflect the company's intrinsic value. Some of these companies fear this situation could lead to unwanted takeover bids and are considering their options. One controversial, but effective option that companies are considering is adopting a shareholder rights plan, colloquially known as a Poison Pill to stave off or at least deter a potential unwanted acquisition.

What is a Poison Pill?

A Poison Pill is a defense mechanism companies can implement to prevent or discourage unwanted acquisition attempts.[1] There are different types of Poison Pills, but they all share the same underlying purpose: a company that receives an unwanted offer activates the Poison Pill to make its shares unfavorable to the acquiring firm or individual by significantly raising the cost of the acquisition.[2] This in turn dissuades investors from initiating unwanted acquisitions without at least negotiating with the target company's board. Consequently, the Poison Pill can result in the target receiving more favorable terms for the offer.

Poison Pills are controversial because they dilute the value of the shares that were owned prior to the activation of the pill and their use may deprive investors of profit they could have realized from a successful acquisition. Many institutional investors are apprehensive about Poison Pills because they can be used to insulate ineffective or self-interested management that may be more concerned with preserving its own employment rather than acting in the best interests of their shareholders.

Institutional Investor and Proxy Advisory Firm Policies

The "Big Three" BlackRock, Vanguard, and State Street all have detailed policies on Poison Pills. One key area of concern for institutional investors is whether a company obtains shareholder approval prior to adopting the plan. When a company adopts a Poison Pill without first obtaining shareholder support its directors may suffer the consequences.

Moreover, even if companies first seek shareholder approval, they still must take appropriate steps to garner

---

[1] https://www.investopedia.com/terms/p/poisonpill.asp

[2] Id.

institutional investor support. Vanguard, for example, "will generally vote against adoption of poison pill proposals … unless company-specific circumstances necessitate providing the board and management reasonable time and protection to guide the company's strategy without excessive short-term distractions. This analysis would typically require engagements with both the company and the acquirer/activist."[3]

BlackRock generally opposes most plans, but "may support plans that include a reasonable 'qualifying offer clause.' Such clauses typically require shareholder ratification of the pill and stipulate a sunset provision whereby the pill expires unless it is renewed."[4]

State Street's policy follows suit. It will generally "vote against the adoption or renewal of a US issuer's shareholder rights plan ("poison pill")."[5] State Street may, on the other hand, "vote for an amendment to a shareholder rights plan ("poison pill") where the terms of the new plans are more favorable to shareholders' ability to accept unsolicited offers."[6]

The two most prominent proxy advisory firms, ISS and Glass Lewis, each have thorough policies regarding Poison Pills. The one salient theme throughout their policies is that they disfavor them, and there can be significant ramifications for directors who are responsible for adopting Poison Pills without shareholder approval.

ISS' policy is to "vote against or withhold from all nominees … if [t]he company has a poison pill that was not approved by shareholders" with certain exceptions for pills with a term of one year or less.[7] ISS looks for specific attributes that ensure Pills are utilized for shareholders' benefit and not to insulate management or the board from an appropriate offer.

ISS recently issued a vote recommendation report for a company that adopted a Poison Pill without submitting it for shareholder approval. ISS recommended shareholders vote against the Chairman of the board because it found the Pill's five (5) percent trigger to be problematic and out of line with market practice. ISS issued cautionary for recommendations for all other directors due to concerns about the Pill. ISS recognized that the company's decision to adopt the Pill came at an unprecedented time, and applauded the company for explaining its rationale for adopting the Pill. ISS also noted that the twelve (12) month Pill duration is not problematic given current market volatility, and appreciated that the company intends to submit the Pill for shareholder approval if extended. Ultimately, ISS determined the against recommendation was appropriate given the adoption of the five (5) percent trigger.

Glass Lewis will recommend that shareholders vote against "[a]ll board members who served at a time when a poison pill with a term of longer than one year was adopted without shareholder approval."[8] Glass Lewis believes that Poison Pills are generally not in shareholders' best interests because they can reduce management accountability and prevent shareholders from receiving a buy-out premium for their stock.[9] As such, Glass Lewis generally recommends that shareholders vote against these plans to protect their financial interests and ensure that they have an opportunity to consider any offer for their shares, especially those at a premium.[10]

Recent Uptick in Poison Pill Adoption

Companies are adopting Poison Pills in far greater frequency in 2020 than in recent years despite institutional investors and the proxy advisory firms' concerns. Sixteen (16) companies in the Russell 3000 adopted Poison Pills between January 1, 2020 and March 26, 2020.[11] Companies are cognizant of shareholders' concerns about Pills with terms greater than one year, as thirteen (13) of those plans have a term of one year or less.

[3] Vanguard 2020 Proxy Voting Guidelines
[4] BlackRock 2020 Proxy Voting Guidelines
[5] State Street 2020 Proxy Voting Guidelines
[6] Id.
[7] ISS 2020 Proxy Voting Guidelines
[8] Glass Lewis 2020 Proxy Voting Guidelines
[9] Id.
[10] Glass Lewis 2020 Proxy Voting Guidelines
[11] Activist Insight Governance, Poison Pill Summary

The adoption of Pills in 2020 far outpaces recent prior years. During all of 2019, only eighteen (18) companies adopted Poison Pills, and between January 1, 2019 and March 26, 2019 only five (5) companies in the Russell 3000 adopted pills.[12] The numbers decrease even more in 2018 when only fifteen (15) companies in the Russell 3000 adopted pills the entire year, and five (5) adopted them between January 1, 2018 and March 26, 2018.[13]

These numbers suggest that companies are adopting Poison Pills in direct reaction to the market's recent volatility. This theory is strengthened by the fact that ten (10) of the sixteen (16) Pills that have been adopted in 2020 were adopted between March 6th and March 26th when the market was dropping in historic fashion. In 2019, only three (3) companies adopted poison pills in March and the number decreases even further to one (1) in 2018.

Recent Proxy Voting Results for Shareholder Rights Plans

The increase in adoption of Poison Pills has not coincided with a similar increase in companies putting shareholder rights plans up for vote. From January 1, 2020 through March 27, 2020 only one (1) company in the Russell 3000 put a shareholder rights plan up for vote.[14] The proposal received significant opposition as less than 30% of the shares cast supported the proposal and ISS recommended against the proposal.[15]

The stats for 2019 tell a different story, however, as four (4) companies in the Russell 3000 put proposals to amend, ratify, or re-approve shareholders rights plans to a vote.[16] All four (4) proposals passed, with three (3) of the four (4) receiving overwhelming support as over 95% of the shares cast supported the proposals and each of the proposals received ISS' support.[17]

What Can Companies Do?

Companies that fear an unwanted offer should consult with counsel and advisors on whether adopting a shareholder rights plan is appropriate. While Poison Pills have been an effective tool in defending against hostile takeovers, and can benefit shareholders if certain protections are included in the plan, they can also deprive shareholders of the opportunity to obtain a premium for their investment.

Companies that ultimately decide to take the plunge and adopt a Poison Pill should consider seeking shareholder approval, thoroughly explain the rationale for adopting the Pill, and limit the scope of the plan so that it can accomplish a particular objective. These companies should also evaluate whether they should include a reasonable qualifying offer clause to the plan. Finally, companies need to assess whether they have sufficient shares available to fund a Poison Pill. After conducting this analysis they may learn that they need to seek shareholder approval to request an increase in authorized shares in order to fund the Pill.

[12] Id.
[13] Id.
[14] ISS Voting Analytics Database
[15] Id.
[16] Id.
[17] Id.