

Recent Developments in Rights Plans in Light of the COVID-19 Pandemic

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The COVID-19 pandemic has caused significant worldwide disruptions of business operations and has negatively impacted stock prices globally. As a result, many corporations find themselves potentially vulnerable to abusive takeover tactics, such as inadequate or coercive takeover proposals and market accumulations by investors seeking to profit from depressed stock prices that may not accurately reflect a corporation's intrinsic value. In addition, some corporations have found that, due to downward movement in their stock price, they are at an increased risk of ownership changes in their stock that would threaten or impair the value of their net operating losses. In order to address these threats, an increasing number of corporations have adopted stockholder rights plans, and many others are preparing rights plans to put on the shelf in case they need to be quickly deployed in the coming months.

The primary purpose of a traditional stockholder rights plan is to protect a corporation's stockholders from hostile and abusive takeover tactics. By deterring would-be acquirers from accumulating a significant stake without negotiating with the board, rights plans help to ensure that all stockholders receive a fair and adequate price for their shares. A rights plan, which can be quickly implemented by a board of directors without stockholder approval, accomplishes this goal by threatening to dilute the ownership stake of any stockholder who acquires shares in excess of the triggering threshold of the rights plan without first negotiating with the board. The principal purpose of a so-called "NOL" rights plan is to deter stockholders from acquiring shares beyond a specified percentage, usually 5%, to limit ownership changes that would threaten the availability of certain tax benefits.

COVID-19 and Recent Trends in Rights Plans

Using statistics and data obtained from Deal Point Data (www.dealpointdata.com), we have analyzed rights plans adopted during the period from Jan. 1 to April 22 (the sample period) and compared them to rights plans adopted in recent years to determine whether there are any emerging trends during the COVID-19 pandemic.

In response to the market disruptions caused by the COVID-19 pandemic, there has been a noticeable uptick in newly adopted rights plans. From Jan. 1 to April 22 in each of the previous two years, 14 rights plans were adopted. During the sample period, there were 49 newly adopted rights plans, representing a 350% increase in rights plan adoptions for this period as compared to each of the previous two years. Moreover, the number of rights plans adopted in the sample period (49) has already surpassed the total number of rights plans adopted in each of the previous two years (41 in 2018 and 42 in 2019).

In addition, set forth below are some trends that have developed during the sample period regarding certain rights plan provisions.

- **Trigger Threshold:** In recent years, the trigger threshold in traditional rights plans has been evenly distributed between 10%, 15% and 20%. During the sample period, trigger thresholds in traditional rights plans are most commonly set at 10% (or less in some cases). Of the traditional rights plans adopted during the sample period, 59% have a trigger of 10% or less, whereas only 31% of traditional rights plans adopted in the previous three years had a trigger of 10% or less. Furthermore, three traditional rights plans adopted during the sample period have a trigger threshold of 5% or less. In the three years prior, only one rights plan adopted for anti-takeover purposes featured a trigger threshold of 5% or less.
- **Dual Triggers:** A majority of the recently adopted traditional rights plans have included a two-tiered triggering threshold—10% for “activist investors” (i.e., Schedule 13D filers) and 20% for “passive investors” (i.e., Schedule 13G filers). Of the 39 traditional rights plans adopted during the sample period, 21 include a dual trigger provision, whereas only nine traditional rights plans adopted in the previous three years included a dual trigger.
- **Derivatives:** All but one of the recently adopted traditional rights plans have provided that the shares underlying derivative transactions and securities and other synthetic positions will be counted for purposes of determining whether the trigger threshold of the rights plan has been reached. In the prior three years, 71% of traditional rights plans adopted contained a derivative provision.
- **Acting in Concert (Wolf Pack) Provision:** A so-called “wolf pack” provision is designed to aggregate for purposes of the triggering threshold the ownership of multiple stockholders who may not have an express agreement, arrangement or understanding among themselves, but are nonetheless acting together towards a common goal. The frequency of these provisions has seen a slight uptick, appearing in 44% of traditional rights plans adopted during the sample period and 36% of those adopted in the previous three years.
- **Stockholder Approval Requirement:** Only 8% of traditional rights plans adopted during the sample period contain a provision terminating the rights plan if it is not ratified by the stockholders at the next stockholder meeting, whereas such provisions were included in 18% of traditional rights plans adopted in the previous three years.
- **Term of Rights Plan:** Traditional rights plans adopted during the sample period have an average term of just 1.20 years, compared to an average term of 3.34 years in traditional rights plans adopted in the three years prior.

Proxy Adviser Guidance in Light of COVID-19

There are also signs that proxy advisers, who generally disfavor rights plans, may be re-assessing their positions in response to the COVID-19 pandemic. On April 8, Institutional Shareholder Services (ISS) released guidance on the “Impacts of the COVID-19 Pandemic,” noting that “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 [rights plan] of less than one year in duration.” That same day, Glass Lewis published similar guidance, stating that the “coronavirus and related economic crisis” provide “reasonable context” for adopting a rights plan that is limited to one year or less in duration and for which the company “discloses a sound rationale for adoption of the [rights plan] as a result of coronavirus.”

Despite the new guidance, proxy advisers will still evaluate rights plan adoptions based on all relevant factors. For example, on March 19, The Williams Companies adopted a one-year traditional rights plan with a 5% trigger threshold “in light of the extreme market dislocation” as a result of the COVID-19 pandemic. ISS recommended a vote “against” the company’s chairman and “cautionary support” for the other directors, noting that while ISS understood the rationale for the adoption of the rights plan and that the one-year duration alone was not problematic, the adoption of

the 5% trigger threshold was too restrictive for a traditional rights plan. In contrast, Glass Lewis supported the adoption of this rights plan and supported the election of all directors, noting that it was encouraged by the right plan's limited duration, The Williams Companies' disclosures and its communication with its stockholders about such rights plan.

Key Takeaways

As a result of the market disruptions caused by the COVID-19 pandemic, rights plans are being adopted in the early part of 2020 at a rate not seen since the 2008 financial crisis. Corporations adopting traditional rights plans are opting for lower trigger thresholds and shorter terms, and are more frequently including specific protective provisions, such as derivatives language and "wolf pack" provisions. These factors, combined with the fact that fewer rights plans are including express requirements that they be submitted to stockholders for approval, likely reflect a determination by many boards, particularly in industries suffering most dramatically from the effects of the pandemic, that the current extraordinary circumstances justify a heightened protective response, at least in the short term. Proxy advisers have also recognized that the adoption of rights plans may be an important means of protecting stockholder interests in the current context. Because the current market disruptions may persist for the next several months, corporations and their counsel should assess whether the adoption of a rights plan is advisable, or whether the corporation should keep a rights plan on the shelf for quick deployment should a specific threat arise. In considering whether to adopt a rights plan, boards may wish to seek and obtain advice from officers and outside experts and advisers regarding the terms of the rights plan, including with respect to the particular risks the plan is intended to address.

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