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■ CORPORATE LITIGATION

The Delaware Court of Chancery Enjoins "Extreme, Unprecedented" Stockholder Rights Plan

In The Williams Companies Stockholder Litigation*, the Delaware Court of Chancery enjoined a stockholder rights plan, having described it as having "an extreme, unprecedented collection of features." Nevertheless, the opinion does not signal a major shift in Delaware law with respect to the adoption and maintenance of stockholder rights plans.*

By John Mark Zeberkiewicz

Stockholder rights plans, or so-called poison pills, are one of the most effective devices that a board of directors can deploy unilaterally to defend against hostile or abusive takeover threats. In general, they subject stockholders to the risk of massive dilution if they acquire beneficial ownership of the corporation's stock above a specified threshold, thereby deterring them from making hostile or abusive takeover offers and effectively forcing them to negotiate with the board. In the wake of the market volatility and economic uncertainty arising out of the COVID-19 pandemic, an increased number of companies adopted stockholder rights plans to protect the long-term interests of stockholders against opportunistic buyers or to protect tax assets.[1]

While many companies adopted traditional anti-takeover rights plans with a single triggering threshold fixed at 15 percent or 20 percent of the voting stock, others adopted anti-takeover rights plans with relatively newer technology that pre-dated the pandemic but appeared well-positioned to address some of the risks associated with the pandemic. These included "dual triggers," that is, a lower triggering threshold (for example, 10 percent) applicable to stockholders filing under Section 13D and a higher triggering threshold (for example, 20 percent) for passive investors, and so-called wolf-pack, or acting-in-concert provisions (that is, provisions that aggregate, for purposes of the triggering threshold, the ownership of stockholders who, although they have no express agreement, act in a coordinated manner toward a common objective). The adoption of rights plans with non-traditional features, particularly the wolf-pack provisions, gave rise to the filing of several

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complaints in the Delaware Court of Chancery,[2] including the challenge to The Williams Companies, Inc.'s rights plan (Plan), which, in addition to having a wolf pack provision, had a highly unusual 5 percent triggering threshold.

In *The Williams Companies Stockholder Litigation*,[3] the Court declared the Plan—which it described as having "an extreme, unprecedented collection of features,"—unenforceable and permanently enjoined its continued operation.[4] Despite the outcome, the Court's opinion in *Williams* supports the view that boards of directors have significant latitude in adopting targeted measures to respond to specific threats. The Court provides substantial guidance as to the process the board should follow in identifying such threats and in crafting appropriate responses to them.

Background

The Williams Companies, Inc. (Williams or Company) is a publicly traded company headquartered in Oklahoma that owns and operates natural gas infrastructure assets. In 2011, the Company became the target of an activist campaign, resulting in a 2014 agreement in which two designees of the activists gained representation on the board. Those designees were "instrumental" in pushing Williams to enter into a merger agreement with Energy Transfer Equity LP, a transaction that ultimately failed and was followed by additional activist intrigue.[5]

The Plan contained a wolf-pack provision that deterred parties from acting in concert.

In March of 2020, against a backdrop of disruption in the global energy market and the onset of the COVID-19 lockdown measures, the Company's stock entered a period of volatility and suffered steep declines.[6] In early March, one of the Company's outside directors recommended the notion of adopting a rights plan geared toward addressing threats from stockholder activism.[7] He proposed a rights plan with a one-year term and a 5 percent triggering threshold, albeit with an exception for passive investors, as the intention would be to insulate management from the distraction of an activist campaign and allow them to focus on operating the business during a turbulent period.[8] As ultimately adopted, the Plan contained, in addition to the foregoing features, a wolf-pack provision that deterred parties from acting in concert as well as a definition of "beneficial ownership" that included options and other derivative securities.[9]

At a meeting on March 18, 2020, with its legal and financial advisors in attendance, the Williams board received a presentation from management with respect to the Plan, including an overview of the core objectives that a rights plan is designed to achieve: Discouraging inadequate takeover offers and coercive or abusive takeover tactics and encouraging bidders to negotiate with the board. The presentation also noted that rights plans are merely a deterrent and will not prevent acquisitions, deter fully priced offers, or prevent proxy contests for board control or stock acquisitions below the triggering threshold. Although the minutes of the meeting indicated that the board discussed the 5 percent triggering threshold, the presentation did not summarize features specific to the Plan.[10] The board, however, received advice from its financial advisor that, among other things, the adoption of a rights plan was a "valid consideration" in light of market volatility stemming from the COVID-19 pandemic and that, in light of current federal securities laws, an opportunistic investor could acquire a sizable position in the stock before the Company would obtain any knowledge or have an opportunity to react to the acquisition. The minutes reflected that the Plan would protect the interests of "long-term" stockholders, including by exempting passive investors.

At a meeting held the following day, the board formally approved the rights plan. At that meeting, the board received a presentation from its financial advisor noting that the Plan, with its 5 percent

triggering threshold, "would deter an activist from taking advantage of the current market dislocation and challenges in monitoring unusual trading patterns."[11] After some discussion, including with respect to the impact of the Plan on the trading volume of the stock, the triggering threshold, and the acting-in-concert provision, the board unanimously approved the Plan. In spite of this record, the Court observed that the key features of the Plan, while a major focus of the litigation, "received little attention" at the March board meetings, where the discussion centered "almost exclusively on the 5 percent trigger."[12]

The Court noted that the public reaction to the Plan was negative, with the proxy advisory firm Institutional Shareholder Services recommending against the reelection of one director on the basis that the board's adoption of the Plan was "'not a reaction to an actual threat . . . of an activist investor or hostile bidder.'"[13] In response, the Company initiated an investor outreach campaign that included an investors' call during which the Company explained the rationale for the Plan, stating that it was intended to

> reduce the likelihood of those seeking short-term gains taking advantage of current market conditions at the expense of the long-term interests of stockholders.[14]

The Company also noted that its experience in the "recent past"—an apparent reference to its history with activism—"reinforced [the] Board's view that 5% is the right threshold in this environment."[15]

The Court observed that, in the face of public disapproval and in spite of a recovery in the stock price, the board "never considered redeeming the Plan."[16] Despite the defendants' assertions in post-trial briefing that the board had determined that redeeming the plan was not in the Company's best interests, the Court found that it had no factual record to support the contention, as the defendants had claimed privilege over the materials relating to the "one occasion" on which the matter was considered.[17]

The Court's Ruling

The Court first addressed whether the claims could be brought directly by the stockholders, as the plaintiffs contended, or whether they had to be brought derivatively in the name of the Company, as the defendants maintained. The Court rejected the defendants' position.[18] Pointing to the Delaware Supreme Court's test in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*[19] for determining whether claims are direct or derivative, the Court stated that

> poison pills, if improper, work an injury on stockholders directly by interfering with at least two fundamental stockholder rights,

namely the right to vote and the right to sell stock. Acknowledging that "[a]ll rights plans interfere to some degree" with those rights, the Court indicated that the level of interference is "nominal" in a traditional rights plan with a relatively high triggering threshold.[20] But the Court found that the Plan's combination of the "parsimonious" triggering threshold and the acting-in-concert provision operated to limit stockholders' ability to communicate freely in connection with an election of directors. In that regard, the Plan inflicted harm on the stockholders directly, and the benefit of an order enjoining the Plan would flow to them directly.[21]

The Court proceeded to review the board's actions under the *Unocal* standard, which requires directors to make two showings: (1) that they had reasonable grounds to believe that a threat to corporate policy or effectiveness existed; and (2) that the defensive measures were reasonable in relation to the identified threat. Analyzing the first prong, the Court observed that the board materials and related documents indicated that the Plan "was intended in part to serve as a takeover deterrent,"[22] but concluded that the Plan was not adopted to achieve that objective, noting, among other things, that "some of the directors did not have that in mind when adopting the Plan."[23] In fact, the Court found that the Plan "was not adopted to protect against any *specific* threat at

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all" but was instead intended "to interdict hypothetical future threats."[24] Despite the Company's history with activists, the Court found that there was no evidence suggesting that the Plan was adopted in light of that history—and cited to testimony from directors suggesting that the rights plan was targeting threats from "short-term" investors and "activist activity" more generally.[25]

The rights plan was targeting threats from "short-term" investors and "activist activity" more generally.

The Court then examined the nature of the threats identified, which required an examination of the board's process. The Court found that the board had demonstrated that it "conducted a good faith, reasonable investigation" in its adoption of the Plan, noting that nearly all of the directors were outside, independent directors, that they had considered the Plan over the course of two meetings, that they had engaged in genuine deliberations and that they had been advised by outside legal and financial advisors. The Court took issue, however, with the threats the board identified, characterizing the first (preventing activism in a time of uncertainty) as too "general," the second (concerns that activists would pursue "short-term" agendas and otherwise disrupt management) as "only slightly more specific," and the third (concerns that stockholders could rapidly accumulate significant positions before the board received notice and had an opportunity to react) as just "a hair more particularized."[26] The Court stated that each was "purely hypothetical," as the board was not aware of any specific activist threat.[27] It then proceeded to address whether the "hypothetical" threats were cognizable under Delaware law.

First, the Court dismissed the notion that stockholder activism, viewed on its own, constituted a legitimate threat, stating that viewing an attempt to influence corporate direction as a threat represented "an extreme manifestation of the proscribed we-know-better justification for interfering with the franchise,"[28] but acknowledging that a board "can adopt defensive measures in response to concrete action by a stockholder activist."[29] Next, the Court noted that it was debatable whether "short-termism" or "management distraction" could constitute legitimate threats. But, having found that the concerns the board had identified were insufficiently concrete, the Court did not see a need to resolve the debate.

According to the Court, generalized concerns regarding short-termism and distraction to management—untethered from specific activities or events—amounted to "mere euphemisms for stereotypes of stockholder activism," rather than cognizable threats. Finally, the Court assumed, without deciding, that the board's concerns that stockholders could rapidly accumulate stock or engage in concerted action without reporting the stock acquisitions for up to 10 days, leaving the Company vulnerable to a "lightning strike raid," constituted a legitimate threat. The Court reviewed the scholarly literature positing the use of rights plans as an effective early detection mechanism to fill gaps in the reporting requirements under federal securities laws.[30] The Court was cautious, however, about flatly sanctioning a rationale that would "provide an omnipresent justification for poison pills," which it described as "situationally specific defenses."[31]

The Plan's features, in the aggregate, constituted a disproportionate response to the rapid accumulation threat.

Assuming that one cognizable threat had been identified, the Court proceeded to analyze the Plan's proportionality to it, starting with the observation that Williams was only one of two Delaware corporations to have adopted a rights plan with a 5 percent trigger (outside the context of an NOL pill).[32] The Court concluded that the Plan's features, in the

aggregate, constituted a disproportionate response to the rapid accumulation threat. The Court compared the Plan's features to less preclusive alternative "gap-filling plans," including a hypothetical plan with a 5 percent triggering threshold and an exemption for stockholders who disclose their acquisitions above 5 percent within two days thereof or who file a Schedule 13D before acquiring shares above the 5 percent threshold.[33] The Court stated that the Plan's features raised concerns when considered independently, and not solely in comparison with less preclusive alternatives. The Court appeared principally concerned with the effect of the Plan's acting-in-concert provision on communications among stockholders. While acknowledging that the Plan contained exceptions for proxy contests, the Court expressed concern that the acting-in-concert provision, by thwarting communications designed to assess stockholders' initial views regarding a proxy contest, could impede their ability to initiate a proxy contest in the first instance. The Court's analysis of the acting-in-concert provision, however, should not be taken out of the specific context in which it appeared—that is, against the backdrop of an uncommonly low triggering threshold.

Key Takeaways

Although the Court of Chancery in *Williams* ultimately enjoined the operation of the Plan, the opinion does not signal a major shift in Delaware law with respect to the adoption and maintenance of stockholder rights plans. As the Court noted in its conclusion, the Plan had an "extreme, unprecedented collection of features." The opinion, however, does provide substantial guidance regarding the manner in which a board of directors should approach the decision whether to adopt a rights plan and, having adopted such a plan, whether to redeem or terminate it or modify its terms.

Shelf Plans

Adopting a "shelf plan" is a sound component of any takeover preparedness strategy. In circumstances where no specific threat has emerged warranting the adoption of a rights plan, having the rights plan "on the shelf"—and a record of the board having engaged in discussions regarding the operation and uses of rights plans generally—can be extremely valuable if a specific threat later emerges that mandates a rapid response. The advance planning and discussion regarding rights plans generally, including the operation of alternative features that are available for potential use, should enable the board, at the time it considers implementing a rights plan, to have more focused discussions regarding the specific threats that have emerged and the specific features designed to respond to those threats.

The Process

The Court did not find fault with the process by which the Company's board adopted the Plan, which process involved deliberating over the course of two meetings and relying on outside legal and financial advisors. In some cases, circumstances may not permit deliberations to extend over multiple meetings. For that reason, advance planning on a "clear day," including the adoption of a shelf plan, may serve to bolster the record. In all cases, boards should seek and obtain input from outside experts and advisors. In addition, the board should ensure the preparation of a clear robust record with respect to the specific threats it identified in adopting the rights plan as well as its determinations regarding the manner in which the specific features of the rights plan respond to those threats. The materials should include not only general summaries of the operation and uses of rights plans, but also appropriately detailed summaries of the specific events or circumstances that have been identified as threats. The materials also should summarize the manner in which specific features of the rights plan address those threats. Longer-form minutes that appropriately detail the board's discussions are bound to provide greater protection to the directors.

If the board is considering the adoption of a rights plan that includes features that are more preclusive than those found in traditional rights plans, it should

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give careful consideration to whether any such feature is critical and, if so, whether a less preclusive alternative will operate to achieve the same objective. If the less preclusive alternative is rejected, the basis for its rejection should be documented. Boards should seek advice from their experts and advisors, including legal counsel, with respect to various provisions. In particular, boards should consider the Court's observations with regard to the acting-in-concert provision in the *Williams* Plan in assessing whether to adopt a rights plan with such a provision.

Triggering Thresholds

Even with an exception for passive investors, the 5 percent triggering threshold in the Plan was off-market for an anti-takeover rights plan. Rights plans with triggering thresholds at the 10 percent range, however, are likely to continue to be adopted. In setting the triggering threshold, the board should consider the specific threats that the corporation faces. If the objective is solely to deter hostile or abusive takeover threats and encourage potential acquirers to negotiate with the board, a 15 percent threshold may suffice. If the board is considering a lower threshold, such as 10 percent, it should give due and careful consideration to the reason for which the lower threshold is needed, and should consider whether to include a higher threshold for passive investors.

Notes

1. In the years leading up to the pandemic, the number of poison pills adopted on an annual basis was in a steady decline. For years ended December 31, 2017, 2018 and 2019, the number of public companies having a rights plan (and the percentage of S&P 1500 companies having rights plans) were 270 (3.6 percent), 200 (1.8 percent), and 171 (1.7 percent), respectively. In the 12 months following March 1, 2020, a total of 97 companies adopted stockholder rights plans, with 22 of those plans being adopted in March of 2020 alone. Of those 97 rights plans, roughly 25 percent were so-called NOL pills designed to protect tax assets. By comparison, in the 12-month period preceding March 2020, only 37 rights plans were adopted, nearly 50 percent of which were NOL pills. Source: *Dealpoint data.*
2. *See* Nathaniel J. Stuhlmiller and Taylor D. Anderson, "Recent Developments Regarding 'Wolf Pack' Provisions in Rights Plans," *Delaware Business Court Insider* (Nov. 11, 2020).
3. The Williams Companies Stockholder Litigation, 2021 WL 754593 (Del. Ch. Feb. 26, 2021).
4. *Id.* at *40.
5. *Id.* at *3.
6. *Id.* at *4.
7. *Id.* at *5. The Court noted that the director "was not concerned with a potential takeover or with NOLs" but instead believed that the "'circumstances that existed because of the pandemic' warranted 'a different type of pill' and that "'uncertainty' in the market required a solution that could 'insulat[e]' management from activists 'who were trying to influence the control of the company.'" *Id.*
8. *Id.*
9. The acting-in-concert provision operated to deem a person to be "acting in concert" with another person where the person "'knowingly acts . . . in concert or in parallel . . . or towards a common goal' with another," "if the goal 'relates to changing or influencing control of the Company,' where each person is 'conscious of the other Person's conduct' and such consciousness is an element in their decisionmaking, and where there is the presence of at least one other factor, as determined by the board, suggesting coordinated activity, such as attending meetings or conducting discussions." *Id.* at *11. It also included what the Court referred to as the "daisy chain" concept, whereby "stockholders act in concert with one another by separately and independently 'Acting in Concert' with the same third party." *Id.*
10. *Id.* at *7.
11. *Id.* at *8.
12. *Id.* at *9.
13. *Id.*at *13–14.
14. *Id.* at *15.
15. *Id.*
16. *Id.* at *16.

17. *Id.* at *15.
18. The defendants argued that Moran v. Household International, Inc., 490 A.2d 1059 (Del. Cha. 1985), *aff'd* 500 A.2d 1346, stands for the proposition that all poison pill challenges are derivative outside of circumstances where an active proxy contest is underway and there is a unique harm to one or more stockholders.
19. Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004). In *Tooley*, the Supreme Court articulated a two-part test for determining whether a claim is direct or derivative, involving an inquiry as to who suffered the alleged harm (the corporation or the stockholders) and who would receive the benefit of a remedy (the corporation or the stockholders individually).
20. *Williams*, 2021 WL 754593 at *20.
21. *Id.* at *20.
22. *Id.* at *23.
23. *Id.*
24. *Id.*
25. *Id.* at *27–28.
26. *Id.* at *29.
27. *Id.*
28. *Id.* at 30.
29. *Id.* at *32.
30. *Id.* at *33–34.
31. *Id.*
32. *Id.* at *35. The Court noted that the other corporation adopted its rights plan in "distinguishable circumstances" in which it was facing a specific threat from an activist holding 7% of its stock.
33. *Id.* at *36–37. The Court also observed that the alternate "gap-filling" rights plans it discussed were proposed with additional "compromise" positions to temper their potential preclusive effects.

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