



CORPORATE UPDATE

“Poison Pill” Defenses in Current Corporate Environment

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April 3, 2020

Poison Pills as Preventative Measures

EXECUTIVE SUMMARY

- Well-prepared public companies—particularly those with now lower market valuations due to the COVID-19 pandemic and the recent oil price collapse—should consider doing the preparatory work for an “on the shelf” shareholder rights plan (“poison pill”)
- Hostile raiders and shareholder activists may seek to take advantage of stock price declines and related vulnerabilities as they did during the 2008-2009 period
- Public companies of all sizes may be at risk, but particularly those with significantly depressed stock prices (both absolute and relative to peers), those exposed to oil price declines, and those with desirable intellectual property
- Companies should consider taking the following near-term steps:
 - Do the homework to place a poison pill “on the shelf” if they have not already
 - Refresh directors on their current “on the shelf” pill terms, fiduciary duties, etc.
 - Analyze and update other takeover defenses and response plans before a hostile suitor or activist appears
 - In appropriate circumstances, adopt short-term poison pills to protect against temporary vulnerability due to exceptionally lower market valuation
- Based on events in 2008-2009, we expect to see the increased rate of pill adoption in 2020 continue, particularly in the second half of the year

“On the Shelf” Poison Pills – Why Have One?

ADVANCE PREPARATION

Well-prepared public companies should have a poison pill “on the shelf”

- We view this as part of good corporate governance practices, particularly for companies with now lower market valuations due to the COVID-19 pandemic and the recent oil price collapse or those with desirable intellectual property or significant NOLs relative to their market value

Rationale for preparing an “on the shelf” poison pill

- At the time a threat arises to require a pill adoption, there will be significant other demands on management’s time
- Prepares documents and diligence for a pill to be adopted quickly at a later date
- Provides framework to update with appropriate tailored terms in response to a specific threat
- Provides evidence of study, deliberation and expert advice in support of the board’s decision to adopt a pill at a later date
- Timing of actual pill adoption relative to the date of the next shareholder meeting may draw proxy advisors’ and investors’ scrutiny if pill ratification is not on that meeting’s agenda
- Waiting to adopt the pill in response to an identified “live” threat provides a clear rationale to proxy advisors and investors to support tailored pill terms and the timing of adoption
- No public disclosure of poison pill terms until implemented, so no public scrutiny to draw attention of activists or others

“On the Shelf” Poison Pills – What Are They?

THE SOLUTION

Steps to put a pill “on the shelf”

- Identify and address potential structural or legal restrictions that could prohibit or delay pill adoption, including available unissued blank-check preferred shares or third party consent requirements
- Analyze how pill fits with the company’s other defenses
- Draft the legal documentation required for later quick adoption (including rights plan, preferred stock certificate of designation, board resolutions and other board materials and public disclosures)
- Make presentation to Board on pill mechanics, benefits/limitations, legal justification, other defenses, etc.
- Select rights agent (typically the company’s transfer agent) to review and approve rights plan
- Tailor pill for the likely needs of the company, with final decisions made at time of any adoption

Putting a pill “on the shelf” stops short of adopting the pill, therefore it does NOT involve:

- Public disclosure
- Formal board action or decision
- Shareholder action or review
- Proxy advisor review or voting recommendation

“On the Shelf” Poison Pills – Refreshment

REFRESHING YOUR PILL “ON THE SHELF”

Consider refreshing the preparatory work for an “on the shelf” pill (including updating pill terms and due diligence) if:

- Given the current market and share price dynamics, the likelihood of hostile activity for the company has significantly increased
- One or more new directors have joined the board who are unfamiliar with current shelf pill or who otherwise need updates to their director education on the latest regarding pill mechanics, benefits/limitations, caselaw and market practice
- Recent financings or other agreements may have imposed new terms that could restrict adoption of existing “on the shelf” pill, such as those contained in new credit agreements, indentures, investment agreements, joint venture agreements or preferred stock certificates of designations
- Increased NOL significance or changes in shareholder ownership justify changing to an NOL pill “on the shelf” instead of a traditional antitakeover pill
- A full suite of pill documents was not prepared when originally putting the pill “on the shelf”

Poison Pills – An Overview

A SHORT REMINDER ON HOW POISON PILLS WORK

Poison pills are designed to make abusive takeover practices prohibitively expensive by severely diluting any shareholder that violates an ownership threshold trigger

- Two principal categories of poison pills are available:
 - Traditional antitakeover pills with ownership triggers typically of 10-20% are effective tools to help ensure the Board can combat abusive takeover tactics, defend itself against inadequate offers and give the Board time to respond in the Company's best interest
 - "NOL pills" are useful tools to help protect the net operating loss carryforwards and other tax benefits of a company when tailored to that goal, including a lower 4.9% ownership trigger
- An acquiror that becomes the owner of shares at the plan's trigger level will suffer severe dilution: all other shareholders (but not the acquiror) will receive shares at a reduced or no cost. The acquiror therefore has the incentive to negotiate with the board (which can exempt the bidder) before crossing the trigger level.
- Any poison pill should be tailored to its purpose and desired functionality
- Importantly, a poison pill cannot prevent a hostile takeover entirely or prohibit a proxy contest

Poison Pill Implementation

ADOPTING THE PILL

For some companies, circumstances may warrant adopting a pill now

- For companies currently faced with an extant threat or who are exceptionally vulnerable, actual adoption of a pill may be the best path
- An active poison pill deters abusive takeover techniques, including rapid share accumulation without a control premium payment and partial or undervalued bids that pressure shareholders into accepting an inadequate price
- Adoption on a “clear day” increases the resiliency of the pill in court if later challenged by a hostile acquiror or a shareholder activist. However, courts have also affirmed the validity of pills as proportional and reasonable responses depending on the nature of an identified threat
- Shorter duration antitakeover pills (one year or less) and NOL pills consistent with proxy advisor guidance are more likely to receive investor support; depending on circumstances, shareholders may also be more receptive to pills adopted in the current climate of market volatility
- The Board may subject the pill to shareholder ratification and/or later evaluate whether to terminate the pill early if no longer needed

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