

Corporate Preparedness in the New Environment: Planning for Shareholder Activist Campaigns or Unsolicited Takeover Activity

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The evolving coronavirus/COVID-19 pandemic, which has caused profound worldwide human suffering, has also severely impacted global business and financial markets. Corporate boards of directors and management teams are confronted daily with myriad challenges in an unstable business environment evolving as quickly as the health crisis. Even as they respond to the immediate risks to employee welfare, business operations and financial stability posed by the crisis, boards and management teams must be looking around the corner to assess and prepare for developing risks to their companies. One such risk is the increased vulnerability of many public companies to shareholder activist campaigns or unsolicited takeover activity, as well-capitalized companies and activist funds may use the significant declines in equity prices as an opportunity to build sizeable positions in targets. While there are some forces that could restrain the overall level of activism and unsolicited M&A in the more immediate term, history suggests that the risk of such activity increases following significant market dislocations.

Prior to the COVID-19 pandemic, companies were well-advised to regularly consider vulnerability to potential threats posed by shareholder activist campaigns and unsolicited takeover activity, and to prepare to respond to such threats. In the current environment, it is particularly appropriate to refresh such preparedness planning, including (i) maintaining a vigilant stock watch program, (ii) conducting a vulnerability assessment, (iii) creating preparedness planning materials, (iv) briefing the board on preparedness posture and planning, activism and takeover tactics, and (v) identifying actions for consideration by the board, such as updating by-laws and placing “on the shelf,” or even adopting, a rights plan with terms appropriate to current circumstances.

A rights plan can be an effective tool to enhance a board’s bargaining power, flexibility and time to deal with an activist or hostile acquiror seeking to accumulate stock to achieve a position of substantial influence or control without paying an adequate control premium or putting a company in play at a time that would not be in the best interests of stockholders. While a rights plan will not prevent an activist campaign, proxy contest or unsolicited offer for a company, by confronting a party that acquires shares without board approval in excess of a threshold (commonly 10% to 20% of outstanding shares) with significant dilution, a rights plan encourages third parties interested in acquiring a significant ownership position in a company to negotiate directly with the board and functions to enhance a board’s leverage to protect stockholders.

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Many companies have already placed rights plans on the shelf to be quickly deployed if necessary. In light of rapidly declining share prices and the risk of activists or hostile acquirors taking advantage of depressed share prices to rapidly build meaningful stakes in targets, a still small but growing (particularly since mid-March) number of companies have taken the additional step of implementing a rights plan due to the market volatility, depressed share values and risks such conditions pose even though a specific threat from an activist or hostile acquiror was not publicly identified. In the coming weeks, there is likely to be greater clarity as to whether the adoption of rights plans under these circumstances represents a shift in market practice on adoption of rights plans and whether proxy advisory services and institutional investors who have traditionally held negative views on rights plans will adopt more permissive views during the current period of market turmoil, particularly where rights

plans are short-term in duration and an adopting company does a good job of communicating why a rights plan was appropriate to address the potential threats it faced.

Given the potential threats that many companies face arising out of the recent severe equity market dislocation, public companies should continue to actively review their overall preparedness posture, including putting a rights plan on the shelf if not currently prepared, or to review a previously prepared shelf rights plan to ensure its terms are appropriate to current circumstances. In some cases, particularly where a company's share price has been particularly hard hit compared to peers or there is a more particularized threat, it may be appropriate to consider actual adoption of a rights plan, with the timing of adoption and design of the rights plan based on the specific circumstances and threats the company faces.