Chancery Court Strikes Down Anti-Activist Poison Pill as Unreasonably Broad

March 10, 2021
By: Clark Collins
Delaware Business Court Insider

In a recent post-trial decision where the Delaware Court of Chancery upheld a stockholder challenge to a “poison pill” rights plan adopted by The Williams Companies’ board of directors, declaring the plan unenforceable and issuing a mandatory injunction against its continued operation. See The Williams Companies Stockholder Litigation, C.A. 2020-0707-KSJM (Del. Ch. Feb.26, 2021). Following the Delaware Supreme Court’s 1985 decision in Moran v. Household International upholding a poison pill as a valid anti-takeover device provided it satisfies the Unocal intermediate review standard, public companies have employed this defensive measure successfully, not only to address takeover threats but also to protect valuable net operating loss assets and to respond to certain stockholder activism. In Williams, however, the court found that the defendants had failed to establish that particular unprecedented terms of the plan constituted a reasonable, proportionate response to the activist threat perceived by the board.

Background

Williams is a publicly traded Delaware corporation that owns and operates natural gas infrastructure handling about 30% of the nation’s natural gas volumes. Following the COVID-19 pandemic and an oil price war between Saudi Arabia and Russia that sent oil prices plummeting, Williams stock price fell almost 55% between January 2020 and mid-March 2020. Management, which previously had an expensive and distracting experience with activist investors, began to consider adoption of a poison pill plan different from the more traditional standby anti-takeover plan “on its shelf.” Typically a poison pill plan involves the issuance of a right to existing stockholders by way of a board declared dividend that, when triggered by the aggregation of a certain percentage of beneficial ownership by a person or group, gives all stockholders but the acquiring stockholder the right to acquire additional shares of the company at a discount, resulting in massive dilution of the acquiror’s holdings.

Concerned about the dislocation current events were having on the company’s market valuation, management advocated a rights plan that would prevent for one year any activism that would influence control over the company at an aggregate level above 5%. The Williams board of directors met twice in March 2020 to consider and adopt the plan as
recommended by management. That plan included a 5% trigger, a broad definition of beneficial ownership extending beyond the federal default provision to include synthetic equity such as options, a sweeping “acting in concert” provision, and a narrow “passive investor” exclusion that failed to exempt stockholders traditionally included in the exempt category. Although the court found that certain aspects of the board approval process were less than perfect, it reasoned that the board’s plan approval process was not unreasonable, since the record reflected genuine deliberation by a board comprised of a majority of, independent, outside directors advised by outside legal and financial advisors. What the court found unreasonable were the plan’s terms, which collectively fell outside the range of a reasonable response to any cognizable threat facing the company.

Discussion

The court employed the traditional two-part *Unocal* intermediate standard of review to analyze the challenge to the plan: Did the board have reasonable grounds for concluding that a legitimate threat to the corporate enterprise existed, and were the defensive measures adopted by the board reasonable in relation to the threat posed. As discussed below, the court found only one of the three threats motivating the board’s adoption of the plan to be possibly legitimate, but concluded that the unprecedented terms of the plan adopted to address the threat were unreasonable and disproportionate.

The court found that the hypothetical threat of general stockholder activism was a not a legitimate threat to the company justifying defensive measures of the magnitude of a poison pill. Noting that stockholder activism is intertwined with the corporate franchise, the court said that it would require evidence of actual conduct by certain activist investors before such conduct could rise to a cognizable threat. Likewise the court found that the asserted concern that activist investors might advocate short-term profit actions or be disruptive were merely hypothetical concerns untethered to actual concrete events and, as such, not a cognizable threat in this case. Finally, the court did reason that using the plan, as an “advance notice” pill to address perceived gaps in the federal disclosure regime, might be a legitimate response to conduct threatening an “orderly stockholder voice,” while expressing skepticism that a response as powerful as a poison pill could be used universally to meet such threat.

Assuming that the threat of “lightning strike” share accumulation could present a cognizable threat justifying defensive measures, the court turned to analyzing elements of the plan under the second *Unocal* prong to determine whether it amounted to a reasonable and proportionate response to such threat. The court concluded the plan was not a reasonable response consistent with the board’s fiduciary duties, focusing on the following elements:

- **5% Trigger:** Except for pills used to protect NOL assets where tax laws justify use of a 5% trigger (not applicable here), the 5% trigger part of the plan was virtually unprecedented. Of the 21 pills adopted by companies during the first three months of the pandemic emergency, only one had a trigger that low, and it was a company facing an actual activist campaign by a 7% stockholder. Thirteen other companies facing ongoing activist campaigns selected triggers higher than 5%, usually in the 10-15% range.

- **Acting in Concert:** The so-called “wolf pack” provision in this element broadly include not only express cooperation agreements but also parallel conduct and sweeps up benign communications relating not just to changing control but also influencing control. It also includes a “daisy chain” concept that could result in one stockholder acting in concert with another he does not even know exists simply by virtue of their separately and independently acting in concert with the same third party. Such a provision has a chilling effect on an activist’s ability to communicate with other stockholders.

- **Passive Investor Exemption:** Although intended to ensure that truly passive investors were exempt from the 5% aggregation trigger, the exemption is defined in a way that would leave subject to the plan’s restrictions...
large institutional investors who acquire shares in the ordinary course and wish to communicate with management or other stockholders about the direction of the company.

The court concluded that the plan’s combination of features were likely to chill a wide range of anodyne stockholder communications and thus failed to fall within a range of reasonable responses to any threat posed.

**Conclusion**

The court’s invalidation of the plan does not undo decades of Delaware law permitting the adoption of poison pills as proper defensive measures when the corporation is faced with an actual threat of a person or group accumulating control without paying an appropriate control premium. Nor does it invalidate pills reasonably designed to address an actual threat posed by certain stockholder activists seeking to control the direction of the company. What it does recognize, however, is that this powerful defensive tool represents a “nuclear” option that may only be wielded to address actual cognizable threats, and then, only in a good-faith reasonable fashion relative to the risk posed. The court rejected the notion that all efforts to influence or change the direction of a company pose a legitimate threat to the company warranting use of a pill designed to prevent any such efforts, a notion that contradicts the essence of the shareholder franchise and the underpinnings of Delaware corporate law.

*Delaware Business Court Insider* I March 10, 2021

If you have questions or would like more information, please contact Clark Collins (pcollins@morrisjames.com; 302.888.6990).