ISS, Rights Plans and the Impact of the COVID-19 Pandemic

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The rapid and significant decline in stock trading prices of many public companies due to the effects of the evolving coronavirus/COVID-19 pandemic has created the risk of activists or hostile acquirers rapidly building meaningful stakes in public companies at depressed prices.

We recently wrote of the importance of companies revisiting corporate preparedness in this new environment in our April 6, 2020, client alert "Corporate Preparedness in the New Environment: Planning for Shareholder Activist Campaigns or Unsolicited Takeover Activity," noting the small but growing number of public companies taking the step of implementing rights plans. While, in recent years, companies have typically not adopted rights plans absent a specific threat due in part to the negative views of proxy advisory firms and certain institutional investors toward rights plans, these views have been evolving given current market conditions. This week ISS published guidance on its policies in light of the pandemic acknowledging the reality that in the current environment implementing a rights plan can be an appropriate action to protect against the threat of opportunistic acquisitions.

ISS' longstanding policy relating to rights plans when making its voting recommendations on director elections is to recommend "against" the election of incumbent director nominees if a company has adopted a rights plan having a term of over 12 months without stockholder approval, and to recommend on a "case-by-case" basis if a company adopts a rights plan having a term of 12 months or less without stockholder approval. In evaluating such short-term rights plans, ISS considers various factors, including a company's rationale for adopting the rights plan, the duration and other terms of the plan, a company's governance structure and practices, the date of adoption relative to such company's next meeting and such company's track record of accountability to stockholders.

The guidance recently published by ISS notes that many of the challenges and uncertainties being faced by investors and companies as a result of the pandemic require understanding and flexibility and commented specifically on rights plans being adopted to protect against the threat of opportunistic acquisitions in the wake of significant stock price declines. ISS stated that its existing policy on rights plans provides for flexibility to account for the adoption of rights plans in the face of genuine, short-term threats such as the pandemic and that a severe stock price decline as a result of the pandemic is likely to be considered a valid justification in most cases for adopting a rights plan of less than one year in duration. ISS also noted that, for companies adopting rights plans, boards should provide detailed disclosure regarding the choice of duration of the plan, or the choice to delay or avoid putting plans to a stockholder vote. ISS also specifically noted that it will continue to closely assess the triggers for such plans within the context of the rationale and length of the plan.

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A recent application by ISS of its policies on rights plans with respect to The Williams Companies, Inc. is instructive of ISS' current thinking. In March 2020, The Williams Companies adopted a 12-month rights plan with a 5% beneficial ownership trigger that contained an exemption for passive investors. The Williams Companies disclosed its rationale for adopting the plan noting its view that the rights plan was appropriate in light of the extreme market dislocation stemming from the pandemic that has resulted in its stock price being fundamentally undervalued and to protect against short-term opportunistic acquisitions in the current environment at the expense of the company and its long-term investors. ISS, in making its voting recommendation with respect to The Williams Companies' directors at the 2020 annual meeting, noted that it understood the unique circumstances that caused the board to adopt a rights plan and that while the 12-month rights plan in isolation is not problematic in the current environment, the adoption of a 5% trigger is problematic as it is highly restrictive and could negatively impact the market for the company's shares as the market recovers. As a result, ISS recommended a vote "against" the company's chairman and "cautionary support" for all the other directors.

ISS' recent acknowledgment that rights plans can be an appropriate action to protect against the threat of opportunistic acquisitions in the current environment and its recommendation in the case of The Williams Companies provide useful guidance to companies considering a rights plan adoption in light of the risks posed by the pandemic and the resulting market dislocation. As the market environment evolves, and with it the view of institutional stockholders, boards of directors will need to thoughtfully assess the risks posed when determining whether a rights plan adoption is an appropriate course. For many companies, it may be sufficient to maintain a rights plan "on the shelf" and to take other preparedness actions, such as closely monitoring the stockholder base through a stock watch program. For others, the evolution of the environment may suggest that current implementation of a rights plan is the appropriate course to protect the company and its stockholders. Clearly, it will be important for companies that adopt rights plans to design the plan based on the specific circumstances and threats facing the company and to clearly communicate to the public the rationale for adopting the plan, the threats facing the company, and how the plan and its terms specifically address those threats.