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Corporate COVID-19 Response Must Look Beyond Poison Pills

By **Jim Woolery, Keith Townsend, Cal Smith, Rich Fields and Matthew Saur**

(May 1, 2020, 5:56 PM EDT) - After years of tremendous economic growth, COVID-19 has unleashed unprecedented market volatility and extreme value dislocations for U.S. public companies. Senior management and directors are facing existential business model, strategic and human resource challenges that are generational in scope.


Jim Woolery

Some law firms and other corporate advisers have responded to the pandemic with a focus on implementing shareholder rights plans, or poison pills, and other traditional defensive measures as a principal corporate response to the pandemic,[1] which has caught the eye of governance experts and media pundits.[2]


Keith Townsend

Updating a shelf poison pill may be prudent depending on circumstances, but traditional defensive prescriptions alone are insufficient as a strategy[3] and may distract senior management and directors from addressing the real issues arising from the COVID-19 crisis.

A comprehensive corporate strategy addressing the company-specific business model, industry, human resources, stakeholders and other enterprise risk is far superior to one that places undue emphasis on poison pills. The best poison pill, in our view, is one that gathers dust on the shelf because a company's proactive corporate strategy makes the pill unnecessary.


Cal Smith

The World Has Changed

The COVID-19 pandemic presents a seismic shift in U.S. public company enterprise risk. Before COVID-19, the shareholder ownership and governance agenda in the U.S. was already dramatically shifting.

Nationalistic trends were clashing with global economic aspirations at an increasing rate. National security, cyber and espionage threats from private actors and nation-states like China had become ubiquitous. Now and going forward, terms like pandemic, quarantine, travel restrictions, remote officing and supply chain impact compound and cement the new and critical enterprise risk regime.

The virus has exposed weaknesses across all U.S. public companies. There is no panacea — poison pill or otherwise — to today's new enterprise risk. Senior management and directors must recognize these new complexities and proactively assess the path forward to address them.

Rich Fields

Our advice is to recognize that, like in all great crises, the appropriate responses and best practices will be iterative. Therefore, our advice to senior management and directors is that traditional defensive approaches are insufficient and can provide a false sense of security.[4]

Dealing with the New Landscape

Matthew Saur

With companies facing more acute enterprise risk, it is vital that strategies and defenses evolve in parallel. This evolution requires a fundamental change in corporate thinking and strategy — one that breaks down internal barriers among departments, adopts technological advances, and allows senior management and directors to be prepared, nimble and proactive, particularly in a time of great crisis. Senior management and directors must see around corners: reacting to yesterday's enterprise risk is not a strategy for success.

To do that, senior management and directors should monitor, preempt and mitigate current and potential threats using the most advanced tools currently available, while crafting a corporate strategy that is nimble and tailored to address company-specific enterprise risks.

Corporate and Shareholder Monitoring

This is the fundamental building block of a thoughtful strategy. It requires senior management and directors to actively monitor their shareholder base (which investors own stock, how the shareholder makeup is changing and why),[5] applicable regulatory regimes (trade policy, cybersecurity, etc.) and market trends (governance, deal activity, etc.).[6]

Monitoring must be fully integrated — both internally across departments and externally with advisers — and incorporate real-time data and feedback from wide-ranging sources, including market news, government alerts, buy-side research and shareholder one-on-ones. In addition, senior management and directors should supplement this monitoring with proactive black hat reviews to identify weaknesses and vulnerabilities of their organizations.

Preemption

Data is useless without action. Senior management and directors must take what they learn through monitoring and proactively address weaknesses and vulnerabilities. This extends beyond disclosures made in the proxy during annual meeting season. It requires a year-round effort that incorporates not only disclosure but also proactive shareholder engagement, routine shelf poison pill updating and implementation strategy, 360-degree board evaluations and refreshment, and policy and regulatory-related analyses.[7]

Key stakeholders must be incorporated throughout the process. A successful preemptive strategy actively patches the holes in the defensive wall, leaving little for interventionists to exploit.

Mitigation

Crises happen. Even the best monitoring and preemptive plans are not fail-safes against every potential risk. Companies must have an on-the-shelf mitigation strategy as a backstop against their key risks. To be effective, the strategy must be regularly refreshed and must also build upon the monitoring and preemption efforts.

Roles and communication protocols among senior management, directors and advisers must be clearly delineated. Establishing and understanding the defensive levers, who is pulling them, and when they should be pulled allows senior management and directors to move with the speed required to take back control at a potential turning point.

Focusing principally on archaic defensive tools and governance debates from the 80s holds little purchase for U.S. senior management and directors following the COVID-19 pandemic. A narrow approach misapprehends this important moment in U.S. corporate history.

Proactive, holistic and bespoke corporate strategies that are integrated across the corporate platform are far superior tools — and a far better use of precious corporate time and resources — to address today's evolving enterprise risk.

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[1] The prevalence of one-year pill limitations in voting guidelines has negatively impacted poison-pill-centered strategies. For example, highly controversial "5% poison pill shareholder ownership triggers" have recently been proposed.

[2] "Companies Rush to Protect Themselves from Hostile Bids" – Barrons, April 10, 2020; "Takeover Targets Get Wiggle Room for Poison Pills in Pandemic" – Bloomberg, April 9, 2020; "Boards Move Swiftly to Adopt Poison Pills" – Agenda, March 27, 2020; and "Coronavirus-Stricken U.S. Companies Pop Poison Pills" – Reuters, March 25, 2020.

[3] The prevalence of one-year pill limitations in voting guidelines has negatively impacted poison-pill-centered strategies.

[4] Actual implementation of a poison pill in the modern era can be necessary in a very narrow set of circumstances. When implementation is necessary, a company and its advisers should be thoughtful in evaluating trigger levels and other terms in proportion to the actual threat posed (versus a draconian approach).

[5] For example, the significant change in passive managers, particularly ETFs, over the last decade. Such managers own 45% of all public companies, up from 25% a decade ago: https://www.cnbc.com/2019/03/19/passive-investing-now-controls-nearly-half-the-us-stock-market.html.

[6] See, for example, the shareholder trend with institutional holders becoming more willing to publicly intervene in M&A activity: https://www.kslaw.com/attachments/000/006/765/original/Wake_Up_Call_Wellington%E2%80%99s_Public_Vote_on_Bristol-Myers_Celgene_Transaction.pdf?1551810205.

[7] See, for example, S.E.C. Chairman, Jay Clayton, and Director, Division of Corporation Finance, William Hinman, encouraging financial and operational reports, particularly those that include forward-looking information, on earnings calls: https://www.sec.gov/news/public-statement/statement-clayton-hinman.