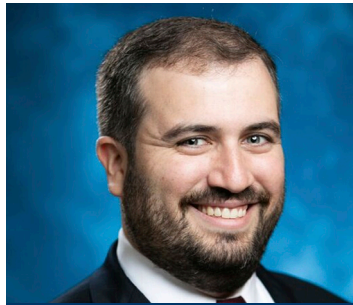


# Shareholder Rights Plans: A Powerful Tool Against Hostile Takeovers



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## What is a shareholder rights plan?

Shareholder rights plans, also known as poison pills, are a takeover defense tool often used to prevent the escalation of a hostile/unsolicited offer by keeping an investor from accumulating a large ownership stake. Shareholder rights plans are one of the most powerful and effective defenses against a hostile takeover. By capping ownership, a pill compels a bidder to negotiate directly with the Board of Directors instead of launching an unapproved tender offer or accumulating an influential/controlling stake through open market purchases.

Shareholder rights plans can level the playing field by giving the Board greater control of a process, providing more time for deliberations and responding to aggressive negotiating tactics. However, a rights plan is not absolute protection. While it does prevent a third-party tender offer from being consummated, hostile bidders and activist funds can still wage a public campaign to pressure the Board to negotiate and redeem a pill.

## How have they evolved over the years?

In the 1980s and 1990s, many companies adopted standing rights plans, often with 10-year terms. Following investor feedback opposing this practice, most US companies ultimately allowed their pills to expire unrenewed.

Today, instead of a standing long-term shareholder rights plan, many companies have a short-term, “on-the-shelf” pill, not implemented but ready to be adopted within 24-48 hours notice. Many investors expect modern pills to have a limited duration (one year or less), ownership thresholds of 10% – 20% and specific disclosed rationale in order to retain investor support. Companies that need a pill with a greater than one-year duration should seriously consider seeking shareholder approval at the next annual or special meeting in order to avoid the risk of Directors failing to be elected.

## What are the key advantages and disadvantages?

Shareholder rights plans are an effective tool to require a bidder to negotiate with the Board. They are convenient because they can be amended or replaced by the Board without delay and are redeemable at a nominal cost so the Board can easily and efficiently approve a friendly merger transaction.

Keep in mind, though, shareholder rights plans do not completely prevent or discourage a merger or cash tender offer. For example, a potential acquirer could condition a tender offer upon redemption of the rights by the Board, or upon the tendering of a sufficiently high percentage of the rights. Additionally, they do not preclude shareholders from seeking changes, typically changes in Board representation, through a proxy contest. Many investors are also often wary of these plans, and they could be viewed as a mechanism for Board entrenchment.

## When should a Board consider adopting one?

There are several scenarios where a Board should at least give serious consideration to adopting a shareholder rights plan. These instances include:

- **Risk of opportunistic/unsolicited bid.** Aggressively-worded letters and/or public filings can indicate that a bidder is willing to escalate pressure on the Board to enter into a transaction. A rights plan can prevent a bidder from building an ownership position to further pressure the Board.
- **Significant recent stock price declines.** Drops in share price can create an opportunity for a hostile bidder or activist to accumulate an outsized ownership stake.
- **High investor turnover.** High volume can allow new actors to accumulate new positions quietly and quickly before they need to be disclosed. Stock watch services can help identify fund accumulation sooner than regulatory disclosure requirements, especially during periods of volatility.
- **Material NOLs at risk.** If a company has a material amount of net operating losses (NOLs) and the favorable tax treatment is at risk due to high investor turnover, a special type of rights plan can protect those tax assets.

To learn more about Activism Defense, contact [ibinfo@stifel.com](mailto:ibinfo@stifel.com).

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