

# Poison Pill Adoptions Head for Record Low

*Agenda*

By Marc Hogan

November 24, 2014

Poison pills look to be on the way out thanks to the surge in shareholder activism in recent years, but for now corporate governance observers say the defensive maneuver still has its uses.

On Nov. 15, **Zoetis** became only the 47th company this year to adopt the anti-takeover device, also known as a shareholder rights plan. According to **FactSet**, which tracks pill adoptions, companies are on pace for about 54 adoptions in the full year, the lowest since the first poison pills emerged in the early 1980s. Last year's 61 would become the second-lowest; as recently as 2009, there were 125.

The nadir comes at the same time as a drop in the adoption of so-called routine poison pills, which are put in place without a looming threat and run the risk of proxy advisors' disapproval. The decline also comes as boards are using the pills, traditionally anti-takeover defenses, against activist investors seeking strategic changes — and some activists have found an antidote.

A poison pill works by flooding the market with more shares if an investor or group of investors acquires a certain ownership threshold in the company. This makes it costlier for the investor to buy up a controlling stake. But it doesn't necessarily block an activist investor pressing for changes if other shareholders find the activist's arguments compelling.

"The pill has value for basically buying you time," says **Charles Elson**, a board member at **HealthSouth** and director of the John L. Weinberg Center for Corporate Governance at the **University of Delaware**. "But it will not stop a transaction from going through."

**Darden Restaurants** said in a Nov. 13 filing that it would allow its pill to expire six months ahead of schedule. The Olive Garden chain owner had used the rights plan, with a 15% threshold, to keep activist investors **Starboard Value** and **Barington Capital Group** from blocking its sale of the Red Lobster brand earlier this year. The pill didn't stop shareholders from voting in October to replace the entire board with candidates put forward by Starboard.

Zoetis, a former **Pfizer** subsidiary, adopted its pill shortly after **Bill Ackman**'s activist hedge fund, **Pershing Square Capital Management**, disclosed an 8.5% stake. Zoetis's pill also has a 15% threshold.

**Allergan**'s recent \$66 billion deal to be bought by **Actavis** likely ended Ackman's efforts to overcome another poison pill.

Ackman and Allergan had agreed in June that his Pershing Square Capital Management wouldn't violate the pill by working with other investors to call a special meeting of shareholders. Ackman had been pushing for an Allergan buyout by **Valeant Pharmaceuticals**.

Allergan's special meeting was still scheduled for Dec. 18 as *Agenda* went to press, amid ongoing litigation over the coordination between Valeant and Pershing Square.

But just because activist investors can circumvent the poison pill does not mean they've defeated it altogether as a defense.

"To paraphrase Mark Twain, reports of the poison pill's death have been exaggerated and are still premature," says **Columbia University** law professor **John Coffee**, in an e-mail response to questions. "But their use has changed. Once, companies adopted them in advance of any takeover to deter the bidder. Today, they are largely adopted in response to a hostile bid."

The shift relates more to the growing clout of proxy advisors than of hedge funds, he says. For instance, **ISS's** voting policies look unfavorably on any poison pill that lasts more than a year without a shareholder vote approving it.

Despite pills' unpopularity with proxy advisors, boards sometimes still find reasons to use the maneuver.

**Ethan Klingsberg**, a partner at **Cleary Gottlieb Steen & Hamilton**, said at a recent **Practicing Law Institute** panel that a board of a widely held company is justified in adopting a pill if an activist with a history of blocking corporate actions discloses that it may attempt to acquire more shares and control of the company. The rationale is to block the activist from acquiring even enough control to block company decisions, or "negative control," without paying all shareholders an appropriate premium.

"The cost will be a bit of backlash from the proxy advisory firms and some institutional holders," Klingsberg says in an e-mail summarizing his panel statements. "And the board will be giving some fodder to the activist to make public statements that the board is more interested in entrenching itself than in the rights of shareholders."

Still, he stresses that given the limitations of poison pills, boards ultimately need to be able to make a better argument than the activist about the company's strategic directors. "The burden is on the board to work with management to craft a plan and investor relations campaign that preempts the hedge fund critique," Klingsberg says.

**Harvard University** law professor **Lucian Bebchuk**, a longtime critic of using poison pills to block takeovers, particularly disapproves of pills used to block activists.

"State law, including Delaware law, still provides boards with expansive and in my view excessive latitude to adopt both types of pill," Bebchuk says in an e-mail response. "In my opinion, anti-activists pills are especially pernicious because an activist's purchase of a significant stake falling far short of control tends to benefit rather than harm non-selling shareholders."

In recent years, the likes of **Netflix**, **Air Products and Chemicals** and **Hertz** have adopted two-tier pills, with a lower threshold for activists. In May, the **Delaware Chancery Court** upheld **Sotheby's** two-tier rights plan against a challenge by **Third Point**, the activist hedge fund led by

**Daniel Loeb.** But Sotheby's settled within days of the court publishing its opinion, and Vice Chancellor **Donald Parsons** stopped short of a broad ruling about the appropriateness of pills used against activists.

**David Katz**, a partner with **Wachtell, Lipton, Rosen & Katz**, the law firm that invented the poison pill, has said Parsons's ruling makes clear boards may sometimes use a rights plan to block hedge fund activism.

"As a general matter, boards of directors facing activist share accumulations and threats of board takeovers can take comfort in this latest affirmation of the respect accorded to an independent board's informed business judgment," Katz wrote in a July [post](#) for the Harvard Law School Forum on Corporate Governance blog.

In any event, the decision to adopt a pill comes with pros and cons. "The adoption of a pill in connection with a proxy contest can be a useful response to limit accumulation, even if the proxy contest does not relate to (or foreshadow) a possible takeover bid," says **Thomas Cole**, a partner with law firm **Sidley Austin** who moderated the recent PLI panel, in an e-mail response. "The decisions of the Delaware courts in Yucaipa and Sotheby's are favorable to boards that do so."

He continues: "However, the pill will not serve as an absolute block and, under certain circumstances, could adversely affect the recommendations of the proxy advisory firms. Moreover, a pill typically will not be effective against a so-called 'wolf pack.' Finally, the adoption of the pill can form the basis for litigation brought by an activist and, thus, the related potential for discovery of documents that may make the proxy contest defense more difficult.

"As evidenced by the **Airgas**/Air Products battle [in 2011], however, a pill remains a highly effective defense against a takeover bid."