

U.S. PUBLIC COMPANIES SHOULD EVALUATE THEIR PREPAREDNESS AND TRIGGERS TO ADOPT A RIGHTS PLAN

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As public companies watch sharp market declines in their stock prices, many are wondering how they should respond.

A number of companies have adopted shelf rights plans that are reviewed by the board of directors on a “clear day” – in the absence of any takeover or activist activity – and at reasonable intervals. The plan would be adopted at a future date if deemed warranted, after consulting with legal and financial advisors. Shelf plans became popular over the past 15-20 years as institutional investors and proxy advisors expressed strong opposition to rights plans generally, unless short-term in nature and approved or ratified by shareholders.

Typically, a shelf rights plan can be adopted quickly by the board in response to a threat. However, it should be noted that HSR rules only require notification where the acquirer would hold total voting securities in excess of \$94 million, which represents almost 20% of a \$500 million market cap company. And a Schedule 13D needs only be filed within 10 days after acquiring beneficial ownership of more than 5%. Further, state takeover statutes may have thresholds of 15% or 20% beneficial ownership. As a result, in light of lower stock prices and high trading volumes, a potential acquirer might accumulate a large percentage of a company’s shares before the board becomes aware of that fact and is able to adopt the plan.

Under Delaware law, the adoption of a rights plan in the absence of a takeover threat would likely be subject to the business judgment rule. By contrast, adoption of (or failure to redeem) a rights plan in the face of a specific takeover threat would likely be subject to heightened scrutiny. In those cases, the board would be expected to show that:

- There is a reasonable basis to believe the proposed takeover poses a threat to a legitimate corporate interest; and
- The adoption of (or failure to redeem) a rights plan is reasonable in relation to the threat posed.

Companies should consider whether to establish a shelf rights plan or, if already in place, whether it is sufficient in the current environment, in consultation with their legal and financial advisors. They should also evaluate their takeover preparedness generally and the circumstances when they believe they would consider formally adopting a rights plan, taking into account the views of their shareholder base and proxy advisory firms.

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William F. Seabaugh

St. Louis

william.seabaugh@bclplaw.com

[+1 314 259 2450](tel:+13142592450)



R. Randall Wang

St. Louis

randy.wang@bclplaw.com

[+1 314 259 2149](tel:+13142592149)

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