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POISON PILLS IN RESPONSE TO SHAREHOLDER ACTIVISM

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ABSTRACT

Once defined as "the nuclear weapon of corporate governance," poison pills were developed as defensive tactics against hostile tender offers and represent one of the most effective weapons in the arsenal of boards willing to reassert their primacy. After being created in the 1980s by Martin Lipton, this tactic gained judicial relevance in 1985, when the Delaware Supreme Court upheld a poison pill as an anti-takeover device in Moran v. Household International, Inc. It was later scrutinized under Unocal's framework and underwent serious transformations in the wake of Williams Stockholders' Litigation.

Williams represents an example of the scrutiny reserved for anti-activist poison pills: while Boards have solid precedents that justify pill adoption in the takeover context, they walk on thin ice when dealing with anti-activist pills. Rather than protecting the firm from an unsolicited acquisition or guaranteeing an adequate premium for shareholders, anti-activist pills aim at fending off activist initiatives started by shareholders themselves. Shareholder activism can be defined as the broad category of stockholder activities intended to change or influence a corporation's direction. Such activities can be carried out by different shareholders, with different purposes and outcomes. Two of the most notable examples are hedge funds and pension funds. Despite belonging to the same group of institutional investors, these actors influence corporations in opposite directions: hedge funds push for changes that increase the stock price, even when those changes only create value in the short term; pension funds further the interests of workers utilizing their last best weapon, capital. In this context, contributing to discouraging the deployment of poison pills, proxy advisors play a key role. Their positions on proxy voting matters have become so influential that several corporations, hedge funds, and pension funds, requested additional disclosure and regulation to the SEC.

Difficult times can be forecasted for boards willing to adopt anti-activist pills. Boards considering the adoption of anti-activist poison pills may face challenges in gaining trust and legitimacy. To mitigate these concerns, these pills will likely need to adhere to standardized features (trigger above 10% in almost all cases, no acting in concert provision, beneficial ownership and passive investor definition). It is expected that the Unocal standard will remain the appropriate standard of review and the two prongs will serve as a reference for the scrutiny of every pill: a reasonable threat, either the threat of creeping control or the desire to preserve a fair election process, and a proportionate response, which will be inspected on a case-to-case basis.

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I. INTRODUCTION

Officially named “shareholder rights plan”, poison pills embrace the essence of their name as for the efficacy and promptness which characterizes them. They allow shareholders to buy additional shares of a company’s stock at a discount, diluting the value of each individual share.[1] Widely used, both as “wartime” pills and “clear day” pills,[2] this strategy was developed by lawyers and investment bankers working for target boards. Part II focuses on the consolidation and scrutiny of poison pills and takeover defenses in general. Shareholder rights plan gained judicial imprimatur after the *Moran v. Household International, Inc*.[3] case, when the Delaware Supreme Court upheld the takeover defense under certain conditions, setting an important precedent for subsequent litigations. Successively, a scrutiny was also established under *Unocal*, as the legal framework for reviewing stockholder challenges to poison pills. The strategy metamorphosed post-Moran and, after being deployed for other purposes, was the protagonist of a famous litigation against the board of The Williams Companies, Inc. In this case, the poison pill at stake is a very controversial one, with unprecedented features and unseen elements. A 5% trigger threshold, an expansive definition of “acting in concert,” and a narrow definition of “passive investor”, all contributed to the sentence of the court declaring the tactic an inappropriate response to the threat in question.

Part III studies one of the most powerful forces that corporations are subject to, shareholder activism. Data on its relevance today, a description of its origins, and its modern developments are examined in this section. Moreover, the debate on the effects of shareholder activism is considered, explaining also the position of proxy advisors in this setting,

Part IV focuses on the intersection of poison pills and shareholder activism. Anti-activist pills are narrowly examined here. Starting from the debate on the standard of review, this chapter goes on to generalize the key takeaways of the Williams Litigation and provide guidelines for possible future pills.

Part V draws the conclusions. Out of five possible threats identified, only two of them seem to be adequate and reasonable to justify the adoption of a pill. Instead, no rule can be derived for

[1] Stephen M. Bainbridge, Corporate Law § 448 (2020).
[2] Ethan Klingsberg, Paul Tiger, and Elizabeth Bieber, Freshfields Bruckhaus Deringer LLP, *Poison Pills After Williams: Not Only for When Lightning Strikes*, (2021), https://corpgov.law.harvard.edu/2021/03/21/poison-pills-after-williams-not-only-for-when-lightning-strikes/
[3] *See* Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985).

the second prong of the *Unocal* test since every pill has to be scrutinized on a case-to-case basis and its proportionality assessed carefully.

II. POISON PILLS AND THEIR CONSOLIDATION AS DEFENSIVE MECHANISM

A. RISE OF THE ANTI-TAKEOVER DEVICE AGAINST TENDER OFFERS

A powerful defense such as the poison pills was needed in response to an equally powerful offense, i.e. tender offers. Defined as "a public offer to purchase at a specific price and terms during a specified period all or part of a class or classes of securities of a publicly held corporation",[4] the tender offer is in practice a public offer to shareholders of the target corporation. A tender offer is only open for a limited period and is made to individual security holders, implying that each one of them can decide whether to tender securities. Furthermore, not only the period is fixed, but also the terms of the tender offer, such as the price offered to purchase securities.[5] The purchase price is usually at a premium to the current market price of the securities to encourage security holders to sell their securities. Equity holders wishing to accept the offer are said to "tender" their shares to the bidder.[6] Takeovers are at the same time the mechanism to enlarge and develop surviving businesses and regulate the market for corporate control. If on one side they are deemed to create value for companies and shareholders, they also serve as a regulatory system for directors in underperforming firms.[7] Among all possible takeover devices, tender offers have proved to be the most effective strategy when compared to similar non-statutory acquisition devices: share purchases and proxy contests.[8] First, when compared to share purchases, tender offers appear to be (1) less time-consuming; (2) less regulated (even though the Williams Act[9] imposed disclosure obligations also on tender offers, share purchases require a greater amount of disclosure by the SEC); (3) less pricey, given that news of an acquisition program typically drives up the stock price and search or transaction costs may be significant.[10] Then, when compared to proxy contests,

[4] Bainbridge, *supra* note 1, at *441.
[5] *Id*. at *442.
[6] Tendered shares are held in escrow until the offer ends. At that time, the bidder may "take down" the tendered shares. If the bidder does so, the escrow agent releases the promised consideration to the shareholders. Otherwise, the escrow agent returns the tendered shares to the owners. Bainbridge, *supra* note 1, at *429
[7] See John Armour & Brian Cheffins, *The Origins of the Market for Corporate Control*, 5 U. Ill. L. Rev. 1835-1866, 1835 (2014) where they pose that the market for corporate control "took on its modern form in the mid-1950s with the emergence of the cash tender offer" and that "the way in which cash tender offers came to dominate the market for control after World War II can be explained primarily by changes in the pattern of share ownership and reduced opportunities bidders had for "managing" the stock price of intended targets".
[8] Statutory forms, such as a merger or asset sale, require approval by the target's board of directors. In contrast, non-statutory techniques do not.
[9] 15 U.S.C. § 78a et seq. The Williams Act refers to 1968 amendments to the Securities Exchange Act of 1934 enacted in 1968 regarding tender offers.
[10] Bainbridge, *supra* note 1, at *428.

considered “the most expensive, the most uncertain, and the least used of the various techniques” for acquiring corporate control, tender offers appear more convenient.[11] Despite the passing of the 1968 Williams Act, which increased transaction costs due to disclosure, proxy rules remain less profitable. Although not essentially unregulated as they were before 1968, tender offers can reap a non-pro-rata share of the gains[12] from a change in control. Shareholders’ gains are determined by the control premium paid by the offeror which, although it could be roughly estimated because of the disclosure mandated, is not always equal to the actual premium paid by the bidder. This is due to the absence of an adequate mechanism for the shareholders to demand full share of the gains.[13] Rational shareholders will, therefore, accept what is offered reasoning that an almost equitable profit is better than none.[14] In conclusion, tender offers are generally far more successful also when compared to proxy contests, especially if followed by a freeze-out merger, which eliminates the complications of dealing with minority shareholders.[15]

Such a remarkable offensive tactic pushed boards to work on equally effective defensive tools, poison pills. In their basic form, they are defined as: “distribution to stockholders of a right which acquires significant economic value upon the occurrence of specified events involving a non-board-approved acquisition of a significant ownership position in the company”.[16] Since this economic value consists of an entitlement to receive money or property from the company or the raider, and the acquisition cannot be consummated without triggering this entitlement, the raider cannot swallow up the company without also ingesting the economic poison represented by the value that has to be delivered upon exercise of the rights.[17]

Pills become pivotal in takeover contexts because Target’s boards of directors function as a sort of gatekeeper in statutory acquisitions.[18] There was a need for defensive techniques capable of reasserting the board’s primacy and extending the board’s gatekeeping function to the non-statutory acquisition setting. In this context, poison pills can be viewed as the product of

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[11] Insurgent contemplating a proxy battle face a host of legal and economic disincentives. For instance: effective defense mechanisms, such as shark repellents or classified boards; management’s informational advantages and investor perceptions; reimbursement of expenses; shareholder apathy and related problems. In recent years, however, proxy contests have become somewhat more common as a new set of countervailing incentives favoring proxy contests have emerged.
[12] Pro rata” is a Latin term used to describe a proportionate allocation. It essentially translates to "in proportion."
[13] In the case that also competing bids or successful management resistance are absent.
[14] Bainbridge, *supra* note 1, at *431.
[15] A freeze-out merger is a transaction in which the controlling shareholder buys out the shares of the minority, delists the corporation, and then takes it private.
[16] Arthur Fleischer, Jr. & Alexander R. Sussman, *Takeover Defense* § 5-6 (5th ed. 1997), https://search.lib.uiowa.edu/primo-explore/fulldisplay/01IOWA_ALMA21420510060002771/01IOWA
[17] *Id.*
[18] Yaron Nili, *Board Gatekeepers*, 72 Emory Law Journal (2022), Available at SSRN: https://ssrn.com/abstract=4052739

defensive and anti-takeover strategies.[19] Poison pills are based on the class of security known as "right", which grants the holder the option to purchase new shares of stock of the issuing corporation.[20] Such plans give the target bargaining leverage to extract a higher price in return for redeeming the pill. Indeed, poison pills are a great tool to discourage hostile takeover but predominantly to obtain a more than fair price. The acquirer remains subject to the pill's effect even if the majority of the target's shareholders accept the bidder's tender offer, providing the buyer with a great incentive to negotiate with the target's board.[21]

The modern poison pill is characterized by three elements: (1) a "flip-over" element; (2) a "flip-in" element; and (3) a redemption provision. (1) In regular pills contracts, the above-mentioned "rights" are attached to the outstanding common stock, usually imposing that the two be traded jointly.[22] Rights are priced so as to make the exercise of the option economically irrational until a triggering event, in which they become exercisable and separate from the common stock.[23] These events usually correspond to the acquisition of, or announcement of an intent to acquire, some specified percentage of the stock by a prospective acquirer.[24] The flip-over feature comes into play if, once the trigger level has been reached, the target is subsequently merged into the acquirer or one of its affiliates. In this case, the holder of each right becomes entitled to purchase common stock of the acquiring company at a convenient price,[25] diluting the interest of the acquirer's other stockholders. The rationale is identical to the general pill's one, which is to cause dilution for the bidder's pre-existing shareholders and generate undesirable balance sheet effects.[26] (2) The flip-in element was implemented because a pill consisting only of a flip-over provision is vulnerable. An example of a pill turned to an advantage by a bidder can be traced to Sir James Goldsmith's takeover of Crown Zellerbach.[27] In this case, the pill only came to play if a freeze-out merger was carried out by the buyer. Goldsmith, after acquiring a controlling block of the company, chose to not perform a merger and thus didn't suffer any poisonous effect. The flip-in effect is intended to prevent these situations, in which the pill precludes anyone from merging with the acquired company and doesn't affect the buyer.[28] This

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[19] Marcel Kahan & Edward Rock, *Anti-Activist Poison Pills*, Boston University Law Review (2019), https://www.bu.edu/bulawreview/files/2019/06/KAHAN-ROCK.pdf
[20] Bainbridge, *supra* note 1, at *451.
[21] *Supra* note 14, at *921.
[22] If the rights traded separately, the potential target corporation would have to issue a separate security and holders might sell common without selling the rights, or vice-versa.
[23] Bainbridge, *supra* note 1, at *452.
[24] Twenty percent is a commonly used trigger level.
[25] Typically, at half price.
[26] Suzanne S. Dawson, Robert J. Pence and David S. Stone, *Poison Pill Defensive Measures*, American Bar Association (1987), https://www.jstor.org/stable/40687130
[27] Mike Tharp, *Goldsmith Wins Fight for Crown Zellerbach Corp. --- Agreement Gives Financier Control of Firm's Board, Names Him Chairman*, Wall Street Journal (1985), https://www.law.upenn.edu/live/files/7645-a
[28] Bainbridge, *supra* note 1, at *455.

feature, when triggered, entitles the holder of each right, except the acquirer and its affiliates or associates, to buy shares of the target issuer's stocks at half price. The intent is the dilution caused in the target shares held by the acquirer, as seen in the previous case.[29] (3) Another crucial feature of a shareholder rights plan is to have flexible redemption provisions, which give the board an option of redeeming the rights at a nominal cost in order to allow desirable acquisitions to be carried out. [30] Two examples of redemption provisions are: the window redemption provisions, in which the board can redeem the rights for a specified period following the issuance; and the white knight redemption provision,[31] according to which the rights connected to a transaction approved by a majority of the continuing directors might be redeemed. For instance, the shareholder rights plan adopted in Moran v. Household International, Inc.,[32] provides an example of flexible redemption provisions. The Household pill, if triggered by the making of a tender offer for 30% or more was redeemable[33]; if, instead, triggered by the acquisition of 20% or more of the stock, the rights were not redeemable.[34] This distinction was intended to deter hostile acquisitions exceeding 20% of the shares, while permitting friendly deals to be conducted.[35] If today the redemption provisions are a fundamental characteristic of pills contracts, a lively debate has characterized the previous decades. In fact, in absolute contrast with the redemption provisions, the mid-1990s witnessed the diffusion of the so-called dead-hand poison pills. The dead hand feature allowed the pill to be redeemed only by the "continuing directors," that is, the directors who were in office when the pill was adopted or their approved successors. A prominent variation of the dead hand provision was the so-called "no hand" provision. The no-hand feature prohibited any directors (whether the incumbent or continuing directors or the hostile bidder's newly elected slate) from redeeming the pill for a limited period of time.[36] Nowadays, these extreme features seem to have disappeared, especially after being invalidated in *Quickturn Design Systems, Inc. v. Shapiro*.[37] In this case, The court affirmed that the delayed redemption provision was invalid under 8 Del. Laws § 141(a), because it prevented a newly elected board of directors from completely discharging its fundamental management duties to the corporation and its stockholders for six months. The provision improperly and illegally restricted the board's

[29] *Id.*
[30] *Id.* at *455-456.
[31] Richard G. Clemens, *Poison Debt: The New Takeover Defense*, American Bar Association (1987), https://www.jstor.org/stable/40686866
[32] *See* Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985).
[33] The Board could redeem the rights at a price of 50 cents per right at any time prior to their being exercised.
[34] Bainbridge, *supra* note 1, at *453.
[35] *Id.*
[36] Xueqing L. Ji, *A New Look at Dead Hand Provisions in Poison Pills: Are They Per Se Invalid After Toll Brothers and Quickturn?,* 44 St. Louis U. L.J. (2000), https://scholarship.law.slu.edu/lj/vol44/iss1/11
[37] Quickturn Design Sys. v. Shapiro - 721 A.2d 1281 (Del. 1998)

exercise of fiduciary duties on matters of management policy, including the ability to negotiate a possible sale of the corporation, which was a matter of fundamental importance to shareholders.

B. CONSOLIDATION OF THE SHAREHOLDER RIGHTS PLAN

1. Moran v. Household International, Inc.

So far, we've described the rise of poison pills and their contemporary characteristics. A fundamental remark that must be made, very closely linked to the previous one, is their consolidation as defensive mechanisms, which can be found in *Moran v. Household International, Inc*.[38] In this circumstance, the Delaware Supreme Court upheld a flip-over pill against challenges based on the board's authority and the board's fiduciary duties. As mentioned above, Household's pill had two triggering events: making a tender offer for 30% or more of Household's shares; and the acquisition of 20% or more of Household's outstanding shares.[39] The rights were immediately exercisable at issuance, but the price was way out of money and there was no expectation that the rights would be exercised.[40] Furthermore, the rights were initially attached to the common stock to ensure that the two were traded jointly. If the rights were traded separately, the target company would have to issue a separate security, and, more importantly, holders might sell common securities without selling the rights or vice-versa.[41] Another characteristic of this pill is that the rights detached once a bidder was on the scene, ensuring that the bidder bought up the rights separately. The rationale is to have the bidder deal with two separate groups, because stockholders may be willing to tender or sell their common but retain the rights. This pill was also designed to have the rights initially convertible into preferred, and only convertible into common in the event of a second-step transaction. This additional provision was implemented to preclude an argument that the right was a sham security. In fact, DGCL §157[42] allows the issuance of rights, but not for takeover defense purposes. The provision was, therefore, conceived to make it appear as though the rights had economic value.[43] In Moran, the plaintiff brought several authority arguments, which

[38] *See* Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985)
[39] Bainbridge, *supra* note 1, at *452.
[40] If issued, the rights were immediately exercisable and would entitle the holders to purchase 1/100th of a share of Household preferred stock at a price of $100.
[41] Bainbridge, *supra* note 1, at *453.
[42] Delaware General Corporation Law § 157, 2020.
[43] *Supra* note 29.

proved to be fundamental for subsequent cases regarding poison pills. For example, plaintiff contended that Delaware law, if it allowed poison pills, would be pre-empted by the Williams Act. The court rejected this argument by stating that there is no state action where private parties act pursuant to a state statute authorizing their conduct.[44] Moreover, it was contended that DGCL § 157 did not allow the issuance of the rights. This matter was already addressed when the structure of the pill was analyzed. A second issue, which arose in connection with the same article, regards the ability of Household to issue rights that entitle its shareholders to buy shares of another corporation. The court resolved the issue by comparing the Household pill to the anti-destruction provisions commonly found in convertible securities.[45] Since the latter is valid, and the right was not a sham security, the court upheld the pill. Finally, the last category of arguments claimed that the board has no power to block shareholders from receiving tender offers. In response to this, the court postulated that, although the board can erect defenses to deter certain types of bids, there must be some mechanism left by which the bidder can present an offer to the shareholders. Therefore, the Household pill was upheld because there were several methods by which one could structure the offer so as to avoid the pill's effect.[46]

2. Unocal Corp. v. Mesa Petroleum Co.

In the same year, Delaware Supreme Court reversed a decision of the Court of Chancery, marking another crucial event in the history of shareholder rights plans. The Unocal case involved a two-tier, front-loaded tender offer.[47] Mesa Petroleum Company, the plaintiff, held approximately thirteen percent of Unocal Corp.'s stock, the defendant. It was offering to acquire an additional thirty-seven percent for $54 per share, and, after securing majority ownership, it planned to squeeze out the remaining shareholders in exchange for subordinated securities. Although such securities had a face value of $54, their fair market value was considerably less. This kind of offer is generally considered coercive: a shareholder wishing to

[44] Lucian A. Bebchuk and Robert J. Jackson Jr., *Toward A Constitutional Review of The Poison Pill*, Columbia Law Review (2014), https://www.jstor.org/stable/23932266

[45] Anti-destruction clauses are a common feature of convertible securities. They give holders of target company convertible securities the right to convert their securities into whatever securities the acquiring company is offering in exchange for target company common stock.

[46] For instance, conditioning the offer on redemption of the pill by the board; soliciting written consent to remove the board at the same time that the offer is made; and conducting a proxy contest to oust the incumbent board.

[47] As illustrated in the following text, a two-tier, front-loaded tender offer is a tender offer for a majority of a company's shares with the explicit or implicit promise of a subsequent merger in which the minority shareholders will be eliminated for inferior consideration.

reject the tender offer may nevertheless feel compelled to accept it because, in case of a successful tender offer, the shareholder will be squeezed out on inferior terms. The Unocal board of directors rejected Mesa Petroleum's offer as inadequate and decided to take defensive action. The board embarked on an exchange offer pursuant to which it would exchange forty-nine percent of its own shares for new, senior debt securities worth $72 per share. Such securities would have been expected to have a fair market value at or near face value. Mesa Petroleum, however, would not be permitted to participate in the offer.[48] The court noted that "[i]n adopting the selective exchange offer, the board stated that its objective was either to defeat the inadequate Mesa offer or, should the offer still succeed, provide the forty-nine percent of its stockholders, who would otherwise be forced to accept 'junk bonds,' with $72 worth of senior debt. Unocal Corp. v. Mesa Petroleum Co.[49] is generally recognized as the attempt of the Delaware Supreme Court to establish an appropriate standard of review on takeover defenses. Indeed, if the court treated takeover defenses as a loyalty question, applying the intrinsic fairness standard, takeover defenses would most likely not survive the scrutiny.[50] On the other hand, if the court treated takeover defenses as a care question, virtually all board's actions would survive judicial review. This is because a duty of care question requires plaintiffs to rebut the business judgment rule's presumption by showing a breach of the preconditions (absence of fraud or illegality, disinterested and independent decision makers, informed decision, etc.). Therefore, a duty of loyalty makes only sense if all takeovers are deemed socially desirable and a duty of care, on the contrary, only makes sense if management resistance to takeovers is always appropriate.[51] In this regard, Unocal attempted to create a middle course by implementing an "intermediate" or "enhanced business judgment" standard of judicial review, best described as a "conditional business judgment rule." The conditional business judgment rule consists of a judicial examination of conduct at the threshold before the protection of the business judgment rule may be conferred. This test is composed of two prongs. (1) The first step places the initial burden of proof on directors, who must first show that they had reasonable grounds for believing that a danger to corporate policy or effectiveness existed. This translates into the requirement of proving good faith and reasonable investigation. The

[48] In addition, the offer was conditioned on the success of Mesa Petroleum's offer. This made Unocal's offer coercive and preclusive: coercive in that shareholders are pressured not to tender to Mesa Petroleum in order to secure the benefit of the company's self-tender, and preclusive in that if there is no Mesa Petroleum transaction there would be no Unocal transaction. Thus, it was, in effect, much like a poison pill. See infra notes 244-251 and accompanying text. However, it was intended to combat a coercive offer, and as such may be reasonable under the circumstances. See infra note 245 and accompanying text. In any event, Mesa Petroleum was advised to effect a partial waiver of the Mesa Purchase Condition for practical reasons. See Unocal, 493 A.2d at 95 1.
[49] *See* Unocal v. Mesa Petroleum Co**.**, 493 A.2d 946 (Del. 1985).
[50] Brent J. Horton, *Terra Incognita: Applying the Entire Fairness Standard of Review to Benefit Corporations*, 22 J. BUS. L. 842 (2020), https://scholarship.law.upenn.edu/jbl/vol22/iss4/2
[51] Bainbridge, *supra* note 1, at *462.

good faith element is satisfied by proving that directors acted in response to a perceived threat to the corporation and not for the purpose of entrenchment in the office. The second element, reasonable investigation, can be viewed as a demonstration that the board was adequately informed, with the standard being one of gross negligence. (2) If the first burden is carried by directors, they must then demonstrate the proportionality of their defense with respect to the threat posed by the hostile bid.[52] These two prongs correspond to the "enhanced" fraction of the business judgment rule theorized under Unocal.[53] For instance, if the directors carried their two-steps burden, the business judgment rule applied; if otherwise, the duty of loyalty's fairness standard applied. The mechanism created by the court is the solution to problems of outcome determination because it allows courts to determine on an individual basis which of the traditional doctrinal standards are appropriate for the case at bar. [54]

C. WILLIAMS' PILL

Before diving into the analysis of this case, it is best to emphasize why this case is so relevant for the sake of this research. The Williams Companies Stockholder Litigation[55] is the most notable example of an anti-activist poison pill enjoined by the court and restricted in its powers. This decision determines that it is "settled law" that *Unocal* was the appropriate standard to assess the board's adoption of a poison pill and its refusal to redeem it, even when dealing with anti-activist pills such as this one.[56]

The plaintiffs in this litigation challenge an anti-activist pill adopted by the board of directors of The Williams Companies, Inc. at the outset of the COVID-19 pandemic and amid a global oil price war. The Williams pill retains so much importance because it is unprecedented as far as core elements and features, redefining, therefore, the whole concept of takeover defenses. Williams is a publicly traded Delaware corporation with its headquarters in Tulsa, Oklahoma. Its main activities are managing and handling natural gas infrastructure assets, given it controls

[52] *Id.*
[53] *See* Unocal v. Mesa Petroleum Co**.**, 493 A.2d 946 (Del. 1985).
[54] Bainbridge, *supra* note 1, at *464.
[55] In re Williams Cos. Stockholder Litig. - 2021 Del. Ch. (Ch. Feb. 26, 2021)
[56] Eric S. Robinson, *The Anti-Activist Pill in The Williams Companies Stockholder Litigation: A Response to Professor Gordon*, CLS Blue Sky Blog (2021), https://clsbluesky.law.columbia.edu/2021/09/01/the-anti-activist-pill-in-the-williams-companies-stockholder-litigation-a-response-to-professor-gordon/

approximately 30% of the nation's gas volumes.[57] At all times relevant to this decision, there were approximately 1.2 billion shares of Williams common stock outstanding. Based on the stock's trading price from March 2020 through the time of trial, Williams' market capitalization ranged from approximately $11.22 to $27.54 billion. About 50% of Williams' outstanding shares are owned by approximately twenty institutional investors.[58] Williams' largest three stockholders— Blackrock, Vanguard, and State Street—collectively hold almost a quarter of the Company's common stock.[59] Williams' plan was adopted in response to a decline in the stock price. Before 2020, Williams' stock price traded at a high of $24.04 and had been relatively stable over the preceding months. In early 2020, the COVID-19 pandemic and the oil price war between Saudi Arabia and Russia started deeply affecting Williams' stock prices,[60] culminating in Williams' stock price fall to $18.90 at the end of February 2020, when a "public health emergency" was declared by the Department of Health and Human Services. This period was marked by a high trading volume and high fluctuation, indicating "a lot of unusual and short-term-type trading."[61] On March 8, 2020, Saudi Arabia cut prices in reaction to Russia's conduct and the impact on Williams' stocks was significant, its closing price on March 9, 2020, was $14.99. By March 19, Williams' stock price had fallen to approximately $11, which was close to a 55% decline since January 2020.[62]

Around early March 2020, outside director Cogut, a retired lawyer who had led the M&A and private equity practices of a prominent New York law firm, conceived a solution for the crisis—a stockholder rights plan (the "Plan").[63] He had a good understanding of poison pills and he knew that they were historically designed to protect companies from hostile takeovers. Cogut knew that acceptable trigger thresholds had declined from 20% to 15%, with the occasional 10% trigger. Cogut observed that companies began using pills to protect their net operating losses ("NOLs") and not just as a takeover deterrent.[64] The director was not concerned with a

[57] Adam O. Emmerich, Trevor S. Norwitz, and William Savitt, Wachtell, Lipton, Rosen & Katz, *The SEC Should Address the Risk of Activist "Lightning Strikes"*, Harvard Law School Forum on Corporate Governance (2021), https://corpgov.law.harvard.edu/2021/03/14/the-sec-should-address-the-risk-of-activist-lightning-strikes/
[58] *Id.*
[59] Rachel Evans, Sabrina Willmer, Nick Baker and Brandon Kochkodin, *With $20 trillion between them, Blackrock and Vanguard could own almost everything by 2028*, Bloomberg News (2017), https://financialpost.com/investing/a-20-trillion-blackrock-vanguard-duopoly-is-investings-future
[60] Mark McDonald, James Langston, and Kyle Harris, Cleary Gottlieb Steen & Hamilton LLP, *Delaware Court Enjoins Poison Pill Adopted in Response to Market Disruption*, Harvard Law School Forum on Corporate Governance (2021), https://corpgov.law.harvard.edu/2021/03/20/delaware-court-enjoins-poison-pill-adopted-in-response-to-market-disruption/
[61] *Id.*
[62] *Id*
[63] Cogut witnessed the evolution of poison pills throughout his career and described them at trial as "the nuclear weapon of corporate governance."
[64] *Supra* Note 52.

potential takeover or with NOLs, rather he felt that the company needed a different type of pill against "any activism that would influence control over the company at an aggregate level above 5 percent."[65] After revising its on-the-shelf pill, the Board held an emergency meeting on March 18, 2020, and voted to approve it. The Board formalized this vote the next day.[66] At the March 19 meeting, with Williams' legal advisors present, the Board attended and sat through Williams' financial advisor's presentation on the purpose of the pill, and its claimed merits.[67] The clear function of the pill was to deter an activist from taking advantage of the current market dislocation. The summary further stated: a key benefit of the pill "is to prevent an opportunistic party from … substantial influence or control without paying a control premium …" and to limit "an activist['s] ability to accumulate a large stake."

The Plan would expire at the end of one year and had four key features: (i) a 5% trigger; (ii) a definition of "acquiring person" that captures beneficial ownership as well as ownership of certain derivative interests, such as warrants and options; (iii) an "acting in concert" provision that extends to parallel conduct and includes a "daisy chain" concept (the "AIC Provision"); and (iv) a limited "passive investor" exemption.[68] All these features, which were a focal point of the trial, received little attention during the meeting in which the plan was approved.

1. The 5% trigger

The Plan established a trigger threshold of "5% or more." The Plan is triggered, and the rights distributed, on "the close of business on the tenth Business Day after" a "Person" (defined as an individual, firm, or entity) acquires "beneficial ownership" of 5% or more of Williams stock or commences "a tender or exchange offer" that would result in their ownership reaching that threshold.[69] Given Williams' market capitalization in March 2020, triggering the 5% threshold

[65] Trial Tr. at 65:5–8 (Cogut).
[66] *Supra* Note 52.
[67] Representatives from Davis Polk and Morgan Stanley attended the meeting.
[68] Ethan Klingsberg, Paul Tiger, and Elizabeth Bieber, Freshfields Bruckhaus Deringer LLP, *Poison Pills After Williams: Not Only for When Lightning Strikes*, Harvard Law School Forum on Corporate Governance (2021), https://corpgov.law.harvard.edu/2021/03/21/poison-pills-after-williams-not-only-for-when-lightning-strikes/#more-136925
[69] Adam O. Emmerich, Trevor S. Norwitz, and William Savitt, Wachtell, Lipton, Rosen & Katz, *The SEC Should Address the Risk of Activist "Lightning Strikes"*, Harvard Law School Forum on Corporate Governance (2021), https://corpgov.law.harvard.edu/2021/03/14/the-sec-should-address-the-risk-of-activist-lightning-strikes/

at the time of adoption of the Plan would have required an economic investment of approximately $650 million.[70]

2. Beneficial Ownership Definition

The pill's definition of "beneficial ownership" for purposes of calculating the 5% ownership threshold was extended beyond the definition set forth under the SEC's Section 13(d) rules.[71] Section 13(d) of the Securities Exchange Act (the "Exchange Act") requires that non-passive investors report "beneficial ownership" of more than 5% of a class of stock but gives investors a ten-day window to report ownership levels using a Schedule 13D form. During that window, the investor is permitted to continue accumulating stock. Also, it does not include derivative securities in the definition of "beneficial ownership."[72]

3. The Acting in Concert Provision

The AIC Provision deems a Person to be "Acting in Concert" with another where the person: (1) "knowingly acts . . . in concert or in parallel . . . or towards a common goal" with another; (2) if the goal "relates to changing or influencing the control of the Company or is in connection with or as a participant in any transaction having that purpose or effect;" (3) where each person is "conscious of the other person's conduct" and "this awareness is an element in their respective decision-making processes;" and (4) there is the presence of at least one additional factor to be determined by the Board, "which additional factors may include exchanging information, attending meetings, conducting discussions, or making or soliciting invitations to act in concert or in parallel.[73] The fourth factor leaves large discretion to the Board in determining the AIC. Williams's pill contains a unique feature, which is uncommon, the "daisy chain" concept.[74] This provides that "a person who is Acting in Concert with another Person shall be deemed to be Acting in Concert with any third party who is also Acting in Concert

[70] *Id.*
[71] 17 CFR § 240.13d-1 - Filing of Schedules 13D and 13G, Legal Information Institute, Cornell Law School, https://www.law.cornell.edu/cfr/text/17/240.13d-1
[72] The Williams Companies Stockholder Litigation, C.A. No. 2020-0707-KSJM at *23 (Del. Ch. Feb. 26, 2021).
[73] *Id.* at *23.
[74] Supra Note 52.

with such other Person."[75] This translates into the fact that a stockholder is deemed to be acting in concert with one another by separately and independently "Acting in Concert" with the same third party.[76] This provision is very restrictive since it allows stockholders to initiate a proxy contest and solicit proxies without triggering the Plan, but it does not exempt routine communications among stockholders before the launch of a proxy contest or tender offer.

The added concepts of parallelism, acting towards a common goal, chain-linked to parties you may not know, expands the idea of "sharing" power and "agreement" without discernible boundaries. Quoting the renowned commentator Jeffrey N. Gordon[77]: "This afternoon perhaps 30,000 people will have acted in parallel to buy tickets to a Yankees game with the common purpose of influencing the outcome through simultaneous cheering (or perhaps booing), and many will buy tickets and go precisely because they know others are acting in the same way. So, under the activist pill definitions, they may be acting in concert."[78]

4. The Passive Investor Definition

The Plan carves out "Passive Investors" from the definition of "Acquiring Persons." This carve-out has the function of ensuring that truly passive investors would be exempt from the definition of Acquiring person and, therefore, not subject to the poisonous effect of the pill.[79] The definition excludes Schedule 13G filers, [80] defined under the Exchange Act as an investor that "acquired such securities in the ordinary course of his business and not with the purpose nor with the effect of changing or influencing the control of the issuer."[81] Nevertheless, the definition of passive investor goes even further and makes the three requirements of the provision conjunctive instead of disjunctive. As testified by the directors themselves, the

[75] *Id.*
[76] Lori Marks-Esterman, Steve Wolosky, and Andrew Freedman, Olshan Frome Wolosky LLP, *Delaware Chancery Court Invalidates "Anti-Activist" Poison Pill*, Harvard Law School Forum on Corporate Governance (2021), https://corpgov.law.harvard.edu/2021/03/16/delaware-chancery-court-invalidates-anti-activist-poison-pill/
[77] The co-director of Columbia Law School's Ira M. Millstein Center for Global Markets and Corporate Ownership, Jeffrey N. Gordon teaches and writes extensively on corporate governance, mergers and acquisitions, comparative corporate governance, and the regulation of financial institutions.
[78] Jeffrey N. Gordon, *Corporate Vote Suppression: The Anti-Activist Pill in The Williams Companies Stockholder Litigation*, CLS Blue Sky Blog (2021), https://corpgov.law.harvard.edu/2021/03/16/delaware-chancery-court-invalidates-anti-activist-poison-pill/
[79] The Williams Companies Stockholder Litigation, C.A. No. 2020-0707-KSJM at *3 (Del. Ch. Feb. 26, 2021).
[80] Kristin Giglia, *A Little Letter, a Big Difference: An Inquiry into Possible Abuse of the 13g/13d Securities Filing Options* (2015). Columbia Law Review, https://ssrn.com/abstract=2565493
[81] *Supra* Note 79.

language was a mistake and the "and", which makes the requirements conjunctive, should have been an "or," making the requirements disjunctive as intended. That being said, even a disjunctive reading of the Rights Plan's Passive Investor Definition is quite narrow.[82] At the time the Board adopted the Plan, Williams had only three 13G filers in its stock: BlackRock, Vanguard, and State Street. Read disjunctively, the Passive Investor Definition would include at most those three investors.[83]

D. THE WILLIAMS COMPANIES STOCKHOLDER LITIGATION

The Board had the authority to redeem or amend the Plan, but it remained in place. At trial, none of the directors offered a reason for why the Board did not redeem the Plan. One director admitted that the Board believed to have achieved full and fair value for the share price. In practice, the board never considered redeeming the Plan.[84] Plaintiff Steven Wolosky filed the litigation on August 27, 2020. The complaint asserted a direct claim for breach of fiduciary duty against the Director Defendants seeking declaratory and injunctive relief regarding the validity and enforceability of the Plan.[85] The court certified a class specified as: "all record and beneficial holders of company common stock who held stock as of March 20, 2020, and who continue to hold stock through and including the date on which the rights plan expires or is withdrawn, redeemed, exercised or otherwise eliminated," excluding Defendants.[86] The trial lasted three days, from January 12 to 14, 2021.

1. Direct Versus Derivative

The first dispute arose in the process of deciding whether Plaintiffs' claim was derivative or direct. While Plaintiff argued that their claim was direct, Defendants argued that Plaintiffs' claim was derivative, thus subject to Court of Chancery Rule 23.1.[87] The logic behind the Defendants' strategy lies in the fact that a derivative claim requires Plaintiffs to make a pre-suit

[82] *Id.* at *28.
[83] *Id*. at *29.
[84] *Id. at *29.*
[85] *Id*. at *35.
[86] *Id*. at *35-36.
[87] Rule 23.1. Derivative Actions, Legal Information Institute, Cornell Law School, https://www.law.cornell.edu/rules/frcp/rule_23.1

demand on the board or to demonstrate that demand would have been futile. Neither a pre-suit demand was made, nor Plaintiffs had demonstrated futility, according to Defendants, and this would require judgment in Defendants' favour.[88] The test for determining whether claims are direct or derivative was established in Tooley v. Donaldson, Lufkin & Jenrette, Inc. ("Tooley") by the Delaware Supreme Court.[89] In this decision, the Tooley opinion recognized that many prior decisions used the so-called "special injury" test to determine whether a suit was direct or derivative.[90] However, the Delaware Supreme Court, reversing the verdict, rejected the special injury test, in favour of a two-pronged standard.[91] Considering the special injury test "amorphous and confusing", the Supreme Court stated that: "The analysis must be based solely on the following questions: Who suffered the alleged harm – the corporation or the suing stockholder individually – and who would receive the benefit of the recovery or other remedy?"[92] Before the adoption of this new two-part test, the leading case for challenges to shareholder rights plans was "Moran I," which stated that claims must be brought via derivatively. This opinion, also called "derivative presumption," drew criticism even before Tooley. For example, Principles of Corporate Governance – published in 1994 by the American Law Institute – pointed out the issue, observing that: cases have divided as to whether the issuance of a 'poison pill' security can be challenged by a direct action on the grounds that it chills voting rights or restricts the alienability of the shareholder's stock.[93] The passage criticized "Moran I" because its "focus on the similarity of treatment misses the pivotal point that fundamental shareholder rights (e.g., voting and alienability) can be infringed by a variety of board actions that treat existing shareholders alike."[94] Also, in 1999, the court in Gaylord criticized Moran's derivative presumption. The remarks were focused on Moran I's failure to acknowledge who suffered the harm. It seemed "obvious" that the plan infringed on stockholders' fundamental rights to sell and vote.[95] Thus, Tooley and Gaylord addressed the flawed logic behind the derivative presumption present in Moran I.[96] Shareholder rights plans, if adopted improperly, do produce an injury on stockholders directly by harming two

[88] *Supra* note at *64.
[89] Tooley v. Donaldson, Lufkin & Jenrette, Inc. 845 A.2d 1031, 1033 (Del. 2004).
[90] *Supra* Note 79.
[91] *Id.* at *37.
[92] *Id.* at *38.
[93] *See* Principles of Corporate Governance: Analysis and Recommendations § 7.01 n.3, at 29 (Am. L. Inst. 1994).
[94] *Id.*
[95] Shareholders have many legal rights, but they are not all of equal significance. Two rights - the right to elect directors and the right to sell shares - are more important than any others, that these rights should be considered "the fundamental rights of the shareholder," and that, as such, they deserve a great deal of respect and protection by law. Julian Velasco, *The Fundamental Rights of the Shareholders*, 40 U.C. Davis L. Rev. 407 (2006-2007), https://heinonline.org/HOL/LandingPage?handle=hein.journals/davlr40&div=17&id=&page=
[96] *Id.*

fundamental rights, to sell and to vote. Although all shareholder rights plans interfere with these rights, a traditional poison pill does not restrict stockholder communications, especially on fundamental matters (such as nominating directors, matters relevant to the stocks owned, and others). Due to its extreme feature, Williams' poison pill went much further and restricted the shareholder's right to nominate or replace directors.[97] This articulation of the harm flows to stockholders and not the Company. In this way, enjoining the Plan is a remedy that affects stockholders alone and not the Company. Thus, the Plaintiffs' claim is direct under Tooley.[98]

2. Standard of Review

The second dispute arose during the process and concerned the standard of review to be applied. While the Defendants argued that the Business judgment rule was the pertinent standard, Plaintiffs claimed that the Unocal test should have been applied. In the wake of the Court's decision in Moran, the Court of Chancery "and the Supreme Court have used Unocal exclusively as the lens through which the validity of a contested rights plan is analyzed."[99] Therefore, also in this circumstance, the High Court held that *Unocal* standard had to be adopted when analyzing each contested rights plan since all poison pills, "by...nature," have a potentially entrenching "effect."[100] Thus, the obedience of the Board of Directors to their fiduciary duties in deploying (and then failing to redeem) the Williams' crisis pill had to be assessed under Unocal.

As mentioned before, the Unocal test consists of two prongs.[101] The first one requires that Directors had reasonable grounds for believing that a danger to corporate policy or effectiveness existed. Practically, the first part of the test is satisfied by showing "good faith and reasonable investigation," in addition to proving that the Board sought to serve a legitimate corporate objective by responding to a legitimate threat.[102] Therefore, the legitimateness of the threat is essential and good faith and reasonable investigation will not be sufficient to save the board.[103] The second part of Unocal requires a board to show that the defensive measures were

[97] *Supra* Note 79.
[98] *See* The Williams Companies, at *45.
[99] Third Point LLC v. Ruprecht, No. 9469-VCP, 2014 WL 1922029, at *15 (Del. Ch. 2014); see also eBay Domestic Hldgs., Inc. v. Newmark, 16 A.3d 1, 28 (Del. Ch. 2010).
[100] *See* Versata Enterprises v. Selectica, Inc., 5 A.3d 586, at *599 (Del. 2010).
[101] *See* Unocal, 493 A.2d at *955.
[102] *Id.*
[103] *Id.*

"reasonable in relation to the threat posed".[104] When assessing the second prong of the test, the court neither substitutes its judgment for that of the Board, nor second-guesses its decision. The court only determines whether the measure falls within "the range of reasonableness."[105] When conducting the proportionality analysis, the court also examines the relationship between the defensive action that the directors took and the problem they sought to address. The court thus examines "the reasonableness of the end that the directors chose to pursue, the path that they took to get there, and the fit between the means and the end."[106]

3. The Decision and Takeaways

The Unocal Analysis places great importance on the motive of Defendants' for acting. The directors must have identified and responded to a legitimate corporate threat.[107] They cannot justify their conduct based on threats that they never identified or beliefs they did not hold. Before turning to the question of whether the threat is legitimate, the court must determine why the Director Defendants acted, making factual findings on the threat or corporate objective to which the Board was responding when adopting the Plan.[108]

The first step that brought the Delaware Court of Chancery to the verdict consisted in determining the motives that pushed Director Defendants to adopt the 'Crisis Pill'. In this case, Williams' lawyer-drafted documents, board minutes, and company disclosures, did not reflect the management's actual objective. As a matter of fact, all the official documents relevant to the 'Crisis Pill' mentioned that the rights plan's purpose was avoiding hostile takeover attempts.[109] Yet, the plan was not deployed to avoid takeovers; actually, the 'Crisis Pill' was not adopted to shield the Company against any specific threat at all. In the trial, in fact, there was no showing of any exhibit of concern about any activist threat. Nor has the management adopted such a rights plan to protect specific corporate assets (*e.g.,* NOL poison pills).[110] Rather, Williams' directors acted pre-emptively to stop whatever hypothetical future threats. Since Williams' prior controversies with activism were not discussed during the official 18th

[104] *Supra* note 82.
[105] *See* The Williams Companies at *50.
[106] *See* Obeid v. Hogan, C.A. No. 11900-VCL, at *13 (Del. Ch. 2016).
[107] *Supra* note 86, at *51.
[108] *Id.*
[109] *See* The Williams Companies at *52.
[110] *Id.* at *54.

and 19th March board meetings, the Court considered the justification of shareholder activism as artificially produced by the board post-adoption of the plan.[111] Most notably, the Court stated that the actual motive that initially persuaded Williams' management to employ the poison pill was the significant decline of the stock price.

Once the Court completed this first analysis, the *Unocal* first step was adopted. As noted, the requirements are that the Board conducted a "good faith reasonable investigation and had grounds for concluding that a threat to the corporate enterprise existed."[112] The Court decided that the Board complied with the requirements relative to the first prong. In fact, the board was nearly composed of all independent outside directors and the company was also advised by legal and financial advisors who explained the plan.[113] Furthermore, the court established that the actual issue was not the process, yet the threat identified by the Defendants. The latter identified three threats; the first two – that "1) the plan "was intended to deter shareholder activism;" 2) the plan was intended to "insulate the board" from the "short term" agendas of shareholder activists specifically – were considered by the court as purely hypothetical and not cognizable threats." The third threat – that "the board was concerned that a shareholder might take advantage of the market disruption to quietly accumulate substantial amounts of stock, given "gaps" in the federal disclosure regime" – was assumed as a legitimate threat by the court – thus moving the scrutiny to the successive step.[114]
The second step of the *Unocal* standard evaluates the reasonableness of the defensive mechanism adopted in relation to the threat posed. Given the second part of the *Unocal* test, the court concluded that the defendants "failed to show that the extreme, unprecedented collection of features" of the rights plan at issue in this case "bears a reasonable relationship to the board's stated corporate objective." The conclusion of the Court was reached following the analysis of the main features of the Williams pill.[115] The trigger threshold was deemed extreme, given the fact that – of the twenty-one pills adopted between March 13 and April 6, 2020 –

[111] For example, Cogut's first mention of the prior activism appears in an April 9, 2020, email exchange with another director, Wilson, where he suggested adding to the "talking points" to be discussed with stockholders that "Corvex and Sorobon [sic] owned, either as beneficial owners or as economic interest owners, 9.96% of our outstanding shares.
[112] *Supra* note 90.
[113] *Id.*
[114] The directors identified the three threats in the prevention of stockholder activism during a time of market uncertainty and a low stock price, the concern that activists might pursue "short-term" agendas or distract management, and the concern that activists might rapidly accumulate over 5% of the stock at an unjustified discount. To expand see The Williams Companies at *64-76.
[115] Lori Marks-Esterman, Steve Wolosky, and Andrew Freedman, Olshan Frome Wolosky LLP, *Delaware Chancery Court Invalidates "Anti-Activist" Poison Pill*, Harvard Law School Forum on Corporate Governance (2021), https://corpgov.law.harvard.edu/2021/03/16/delaware-chancery-court-invalidates-anti-activist-poison-pill/

only the Williams pill presented a 5% threshold.[116] Most notably, among these twenty-one corporations, thirteen were facing ongoing activist campaigns at the time of the adoption of the pills. Also, other features were scrutinized, for instance, the "beneficial ownership" denotation went far beyond the default definitions and the AIC Provision exceeded the concept of "parallel conduct" (common to federal law) and added the mentioned daisy-chain concept.[117] Lastly, Williams' managers defined "passive investor" in a way that overstepped "the influence-control default of federal law to exclude persons who seek to direct corporate policies."[118] To sum up, the court asserted that Williams' pill went far beyond the ordinary poison pill. Given the extreme nature of the pill, and that the board's decision to adopt the pill did not withstand scrutiny under Unocal – the Delaware Court of Chancery imparted a "mandatory" injunction requiring that the 'Crisis Pill' be withdrawn.[119]

E. RELEVANCE OF POISON PILLS TODAY

Deal Number	Date of Adoption	Expiration Date	Pill Status	Issuer Name	Status Flip-In Trigger %
154087772574	25/09/2022	25/09/2023	In force	Purple Innovation Inc	5.0%
154087713864	20/09/2022	30/06/2023	In force	SilverBow Resources Inc	15.0%
154087710843	19/09/2022	19/09/2023	In force	Nordstrom Inc	15.0%
154087701117	12/09/2022	12/09/2023	In force	Innovative Solns & Support Inc	15.0%
154087700195	08/09/2022	12/09/2025	In force	CBL & Associates Ppty Inc	20.0%
154087701183	18/08/2022	18/08/2023	In force	KVH Industries Inc	15.0%
154087675907	08/08/2022	06/08/2023	In force	Kaltura Inc	15.0%
154087605974	10/06/2022	10/06/2025	In force	Zymeworks Inc	15.0%
154087595618	11/05/2022	11/05/2023	In force	Trecora Resources	15.0%
154087595555	10/05/2022	10/05/2025	In force	International Seaways Inc	15.0%
154087558023	22/04/2022	21/04/2023	In force	Sylvamo Corp	15.0%
154087546226	15/04/2022	14/04/2023	In force	Twitter Inc	15.0%
154087595604	01/04/2022	01/04/2025	In force	Intertape Polymer Group Inc	15.0%
154087576117	21/03/2022	20/03/2023	In force	Rayonier Advanced Materials	15.0%
154087559700	14/03/2022	26/05/2022	Expired	WisdomTree Investments Inc	15.0%
154087493145	21/02/2022	21/02/2025	In force	HP Inc	15.0%
154087574935	08/02/2022	08/02/2025	In force	Noble Mineral Exploration Inc	15.0%
154087466669	05/02/2022	05/02/2023	In force	Kohl's Corp	15.0%
154087590310	02/02/2022	02/02/2025	In force	Team Inc	15.0%
154087530253	27/01/2022	27/01/2027	In force	Devonian Health Group Inc	15.0%
154087589094	27/01/2022	27/01/2025	In force	Bell Copper Corp	15.0%

Using the Screener by Refinitiv Eikon, we can show the relevance of poison pills in North America in 2022. The majority of companies included in the graph are listed on the New York Stock Exchange, with the exception of some companies listed on the Nasdaq, Toronto Stock

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[116] *Id.*
[117] *Id.*
[118] *See* The Williams Companies at *78.
[119] *Id.* at *82.

Exchange, and TSXVenture. Each poison pill has its own terms and conditions but is often triggered when a shareholder accumulates 15% of shares outstanding. The industries of reference are diverse: Paper Mills & Products, Social Media & Networking, Plastics, Investment Management, etc., signaling that no industry is particularly inclined toward the adoption of shareholder rights plans.[120]

The number of pills adopted or renewed by companies in 2022 is comparable to the one of the previous year. In fact, in both years, 21 companies approved the adoption of poison pills. Also in this case, the industries of reference are very diverse. Differently from what we see in 2022, the flip-in trigger thresholds are much more variable. Three companies adopted very stringent pills, characterized by a 5% trigger threshold.[121]

Deal Number	Date of Adoption	Expiration Date	Pill Status	Issuer Name	Status Flip-In Trigger %
154087431941	28/12/2021	28/12/2024	In force	Mercury Systems Inc	15.0%
154087443910	22/12/2021	20/12/2024	In force	American Airlines Group Inc	5.0%
154087438215	21/12/2021	21/12/2024	In force	Navient Corp	15.0%
154087431956	20/12/2021	20/12/2022	In force	Sagaliam Acquisition Corp	15.0%
154087576065	13/12/2021	12/12/2022	In force	MagnaChip Semiconductor Corp	15.0%
154087590324	07/12/2021	07/12/2024	In force	DIRTT Environmental Solutions	15.0%
154087668696	20/11/2021	01/12/2023	In force	Lumen Technologies Inc	4.9%
154087558041	19/11/2021	19/11/2025	In force	Daktronics Inc	20.0%
154087590282	17/11/2021	17/11/2024	In force	Immersion Corp	5.0%
154087559742	03/09/2021	31/08/2022	In force	Spok Holdings Inc	15.0%
154087589073	28/08/2021	28/08/2022	In force	RR Donnelley & Sons Co	15.0%
154087164571	06/05/2021	09/05/2022	In force	Primo Water Corp	15.0%
154087161929	02/05/2021	01/05/2022	In force	Westwood Holdings Group Inc	15.0%
154087150179	19/04/2021	24/06/2021	In force	Commercial Vehicle Group Inc	15.0%
154087145038	14/04/2021	20/04/2021	In force	Audacy Corp	15.0%
154087145034	13/04/2021	31/12/2022	In force	Advanced Emissions Solutions	5.0%
154087558020	08/04/2021	07/04/2022	In force	Dawson Geophysical Co	15.0%
154087144975	25/01/2021	01/04/2021	In force	Chicos Fas Inc	15.0%
154087038445	19/01/2021	13/01/2023	In force	Synaptogenix Inc	15.0%
154087164580	08/01/2021	08/01/2022	In force	Steel Connect Inc	15.0%
154087038413	04/01/2021	30/12/2021	In force	INmune Bio Inc	15.0%

[120] Refinitiv Workspace. (May 8, 2023). *Corporate Governance Market Overview*. Available at: https://workspace.refinitiv.com/web/Apps/CorpGov/
[121] *Id.*

III. SHAREHOLDER ACTIVISM AS A FORM OF CORPORATE GOVERNANCE

A. THE ORIGINS OF SHAREHOLDER ACTIVISM

As we've seen in Chapter II, shareholder rights plans were born during the takeover wars that erupted in the 1970s and early 1980s to fend off unwanted tender offers. However, they evolved to be much more than what they had been created for, performing the function of defensive mechanism against Shareholder Activism.[122] "Shareholder activism" is a broad concept that refers to a range of stockholder activities intended to change or influence a corporation's direction. Activists may pressure a corporation to make management changes, implement operational improvements, or pursue a sale transaction. They may seek to catalyze or halt a merger or acquisition. In contrast to Henry Manne's famous description of the "market for corporate control," shareholder activism exists in a "market for corporate influence."[123] Activists acquire an economic interest in a target for at least three reasons. First and foremost, they want to profit. Activist hedge funds study the company and develop proposals that, according to their assessment, would increase the company's share price. Some of them also hire professional financial advisors to assist them in the task of developing a detailed financial plan. Once the strategy is formulated, activists need to spend resources to persuade the board to adopt it or to convince other shareholders to exert pressure on the board. In some instances, activists decide to wage a proxy contest, which entails further expenses.[124] Even if all these activities end up increasing the company's share price, activists will only derive profits if the increase in the value of their stake exceeds the expenses they incur. The larger the stake they possess, the lower the break-even point in the increase in price that produces profits for the activist. Confronting bidders' strategy to activists', the former profits from buying the target and increasing its value, while the latter from improving the company *without* acquiring it. Second, a larger economic stake lends credibility to activists.[125] Boards or other shareholders will likely pay much more attention to the proposals of activists that possess a large stake in the company. Even if they listen to the proposal, they may be concerned that an activist with a small stake has a second agenda or seeking benefit not shared by the rest of the class; by

[122] *Supra* Note 75.
[123] Henry G. Manne*, Mergers and the Market for Corporate Control,* 73 J. POL. ECON. 110, 115-17 (1965), https://www.jstor.org/stable/1829527
[124] *Supra* note 16.
[125] *Id.*

contrast, an activist with a large stake could prove its genuine intentions by putting its money where its mouth is. Third and last, a larger block of shares provides the activist with more votes in a proxy contest. Ceteris paribus, an activist with a larger stake will be able to make the threat of a contest more credible.[126] In large companies, where a small percentage stake can lend credibility to an activist, even a pill with a threshold of 1% - which is unprecedented - would not stop a hostile bid in its tracks.[127] A bidder would acquire a small fraction of shares, announce a hostile bid, and threaten a proxy contest if the board failed to redeem the pill. If shareholders found the bid attractive, the proxy contest would be successful despite the bidder's small stake, and the bidder would recover the costs of the contests from the profits of the acquisition. By contrast, pills that are overly restrictive could, in the extreme, eliminate the profits from activism—and thereby activism itself.[128]

The debate on shareholder activism tends to focus on whether shareholder activism, in general, is appropriate. Advocates laud its virtues and opponents draw attention to its vices. But shareholder activism is a front in a wider battle between managerial capitalism, an approach that incorporates the primary norm of managing the corporation for the benefit of all stakeholders, and shareholder-centric capitalism, which views the management of the corporation primarily for the benefit of shareholders. In this clash, shareholder-centric model is increasingly gaining control. Managerial capitalism, whatever its virtues, is fighting a rear-guard action against the proponents of shareholder power, increasingly supported by federal regulation.[129] This support suggests that shareholder activism will likely continue to be a central feature of corporate governance for years to come. Shareholder activism comes in at least two primary forms and several sub-forms: Performance-driven activism and corporate governance activism. The former, usually instigated by hedge funds, focuses on advocating for significant changes in corporate strategy to increase the market price of a company's stock; the latter, instead, focuses on changes in a public company's governance arrangements, executive compensation, and social policy.[130]

1. History of the Phenomenon

[126] *Id.*
[127] For example, ValueAct held only about 1% of the shares in Microsoft when it successfully engaged with the company, but these shares had a value of $2 billion. See Emily Glazer & Shira Ovide, *Hedge Fund Invests in Microsoft*, Wall Street J., (2013)
[128] *Supra* note 118.
[129] Paul Rose and Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance* (2015). Brigham Young University Law Review, https://ssrn.com/abstract=2324151
[130] *Id.*

Shareholder activism in the U.S. is by no means a new phenomenon. In the early 1900s, American financial institutions such as insurance companies, mutual funds, and banks were active participants in U.S. corporate governance.[131] In many cases, the representatives of such institutions served on corporate boards and played major roles in the strategic direction of the firm. But over the next three or four decades, laws passed with the aim of limiting the power of financial intermediaries also prevented them from having an active role in corporate governance.[132] Following the stock market crash of 1929, the Glass Steagall Act[133] and many others were passed, prohibiting U.S. banks from owning equity directly and limiting the liquidity of investors of active participation in corporate affairs. The consequence of such laws and regulations was a progressive widening of the gap between ownership and control in large U.S. public companies—a process that continued until the emergence of corporate raiders and LBOs in the 1980s.[134] The current wave of U.S. shareholder activism can be seen as dating from the SEC's introduction in 1942 of a rule (the predecessor of today's rule 14a-8) that first allowed shareholders to submit proposals for inclusion on corporate ballots. Since that time, the identities and objectives of shareholder activists have changed significantly. From 1942 through the end of the 1970s, shareholder activism was dominated by individual investors.[135] The 1980s, by contrast, saw an increase in the involvement of institutional investors, at first mainly public pension funds. These pension funds submitted shareholder proposals, pressured management "behind the scenes" for corporate reforms and used the press to target the management and boards of poorly governed or performing companies. The 1980s also saw the rise of corporate raiders—perhaps the ultimate activists—who began imposing discipline on boards and management using the market for corporate control. But with the decline of the takeover market during the 1990s, and regulatory changes that enhanced the ability of shareholders to communicate on voting issues, activist institutional investors again came to the fore. Indeed, until the recent emergence of hedge funds, the most activist institutional investors have been public pension funds and union funds.[136]

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[131] Stuart Gillan and Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, Journal of Applied Corporate Finance ((2007). https://ssrn.com/abstract=959670

[132] Mark J. Roe, 1990, *Political and Legal Restraints on Ownership and Control of Public Companies*, Journal of Financial Economics 27, 7-41, https://www.sciencedirect.com/science/article/pii/0304405X9090019V

[133] The Glass-Steagall Act effectively separated commercial banking from investment banking and created the Federal Deposit Insurance Corporation, among other things. It was one of the most widely debated legislative initiatives before being signed into law by President Franklin D. Roosevelt in June 1933.

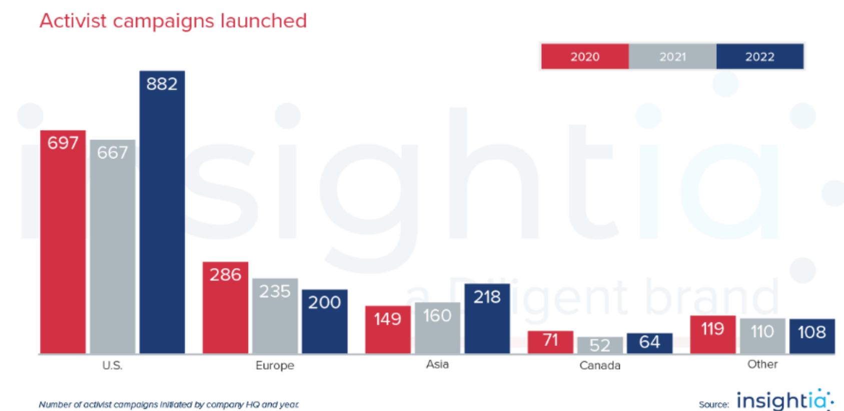
[134] *Supra* Note 125.

[135] *Supra* Note 124.

[136] *Id.*

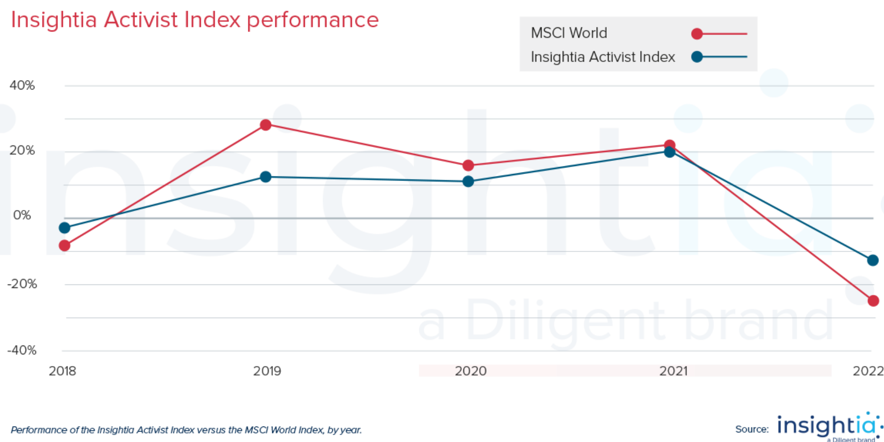
2. Data on Shareholder Activism

Here we can appreciate some data describing the evolution of shareholder activism in recent years.[137]



The number of companies publicly subjected to new campaigns by activist investors worldwide hit 929 in 2022, a 6% increase on 2021. Perhaps most importantly, activists avoided some of the biggest pain points in the market as highly valued growth stocks came crashing down to earth in the face of inflation and recessionary concerns. Indexes mirroring the activist market such as the "Insightia's Activist Index" recorded a 12.9% loss in 2022, compared with a 25.1% loss for the MSCI World Index. Thus, the Activist Index outperformed the World Index, as already happened in 2018, another down year for the market.[138]

[137] *U.S. companies subjected to new activist campaigns increased by 10.6% in 2022, according to diligent* (2023) *Diligent*, https://www.diligent.com/news/us-companies-subjected-to-new-activist-campaigns-increased-by-ten-point-six-percent-in-2022/
[138] *Id.*



The outlook for activism in the U.S. is perhaps the best in years, despite an extended run of defeats in 2022's marquee campaigns. That is thanks in part to the universal proxy rules, which have sent a jolt through the industry.[139] Settlements have risen compared with last year since the rules came into effect in September. In fact, the universal proxy card is likely to drive more settlements or proactive moves by companies to address board weaknesses. [140]

Activist board seat demands

	Settlements					Went to vote (proxy contests*)				
Company HQ	2018	2019	2020	2021	2022	2018	2019	2020	2021	2022
U.S.	150	120	91	67	91	31 (31)	27 (27)	22 (20)	22 (22)	23 (17)
Canada	24	11	11	6	6	14 (11)	7 (5)	10 (6)	5 (5)	4 (3)
Europe	22	23	16	18	9	56 (26)	62 (34)	34 (18)	30 (18)	42 (18)
Asia	5	13	8	4	8	36 (17)	32 (20)	37 (26)	46 (18)	55 (27)
Australia	17	11	8	12	10	24 (20)	30 (27)	33 (28)	27 (19)	23 (17)

Number of resolved activist board representation demands by method and region.
**A proxy contest is defined by Insightia as when dissident nominees receive public opposition from the company.*
Source: insightia

The graph above shows the number of received activist board representation demands. We can see that the US leads with a significant margin over the rest of the world. The numbers show a decreasing trend in settlements from 2018 to 2021 in almost all areas except for Asia, until the trend reversal in 2022, likely motivated by the introduction of the universal proxy cards.

[139] *Fact sheet: Universal proxy rules for director elections* (2022) *www.sec.gov*. https://www.sec.gov/files/34-93596-fact-sheet.pdf
[140] *Supra* Note 132.

B. THE MODERN-DAY MARKET FOR CORPORATE CONTROL

1. Hedge Fund Activism

During the past decade or so, hedge funds have not only entered the shareholder activism arena but have become a dominant force. But what are hedge funds precisely?
There are no statutory definitions or unanimously accepted definitions for hedge funds.[141] Instead, hedge funds are defined according to their distinct features. They are typically structured as a limited partnership or limited liability company and are usually administered by a professional manager known as a "fund manager[142]." In a limited partnership hedge fund, the fund manager is a general partner and the investors are limited partners, implying that the fund manager is personally liable for the affairs of the hedge fund. This management structure provides with tax and regulatory advantages such as the exemption from income taxes on the return of its investments.[143] Instead, partners pay personal income taxes determined according to their share of the returns. Hence, unlike corporations, the hedge fund avoids the problem of double-taxation. These institutions are exempt from a variety of other regulatory requirements: they are not subject to the United States Investment Company Act, which regulates the organization of companies and other entities that engage in investing, and they're often exempt from the disclosure requirements of the United States Securities Act. Thus, they do not have to satisfy some of the onerous disclosure and reporting requirements associated with these regulations.[144]

It would be now convenient to examine their role in capital markets. A very recent event may help us understand the influence that these investors have. On Tuesday, March 2nd, notable short-seller Hindenburg Research[145] published a report alleging that the company controlled by activist investor Carl Icahn was overvalued, over-leveraged and overstated the value of its

[141] John C. Coffee & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance* (2016) 41:3 J Corp L 545, https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=2929&context=faculty_scholarship
[142] William Fung and David A. Hsieh, *A Primer on Hedge Funds* (1999) 6(1) J Empirical Finance 309 at 310, https://people.duke.edu/~dah7/primer.pdf
[143] Gregory Connor and Mason Woo, *An Introduction to Hedge Funds* (2004) 2 IAM 1 at 9, http://eprints.lse.ac.uk/24675/1/dp477.pdf
[144] *Id.*
[145] Hindenburg Research LLC is a U.S. investment research firm with a focus on activist short-selling founded by Nathan Anderson in 2017.

holdings. Mr. Icahn is a legendary activist investor who has built a fortune buying stakes in companies and agitating to impact positively the stock price. He has spent his career criticizing chief executives and boards of directors and tenaciously focusing on boosting profits for shareholders. Conducting high-profile campaigns such as the ones against Dell Technologies, Herbalife Nutritions and Illumina, he was able to accumulate more than $16 billion. Much of that fortune is tied up in Icahn Enterprises, a publicly traded limited partnership in which Mr. Icahn controls 85% of the shares. Icahn Enterprises' shares lost roughly a fifth of their value after the publication of the report.[146] Hindenburg is using a similar playbook to its bet against Adani earlier this year. It took a short position in a company whose shares are controlled mostly by family, which had borrowed against its shares. In Adani's case, the Hindenburg report spurred selling by outside investors, but there were few ready buyers, so the shares plummeted in value. That raised the risk of the family getting margin calls, which sent the shares tumbling further.[147]

This story, already defined as the "Battle of the Activists",[148] illustrates one of the goals that Hedge funds strive for, but they have several others: changing management strategy or board decisions; seeking a board seat for either input, control, or information purposes; effecting corporate governance changes; forcing a buyout or sale of a division; and increasing cash distributions to shareholders through dividends or share repurchases. While hedge funds use some of the same strategies as those employed by the traditional institutional activists—including shareholder proposals, direct negotiations, and use of the media—they also use other means such as proxy contests, litigation, or outright takeover.[149]

During the past few years, hedge funds and private equity funds have become increasingly important players in financial markets, particularly in their capacity as monitors of corporate performance and agents of change. In many respects, the hedge funds that take large, relatively long-term positions in underperforming companies (and, contrary to popular perception, there are a significant number of such funds) can be viewed as the modern-day equivalent of the

[146] Ben Foldy (2023) *Battle of the activists: Hindenburg Shorts Icahn*, *The Wall Street Journal*. Dow Jones & Company, https://www.wsj.com/articles/battle-of-the-activists-hindenburg-shorts-icahn-adc69c59?mod=Searchresults_pos1&page=1

[147] Shankar Ramakrishnan, Svea Herbst-Bayliss, and Carolina Mandl (2023) *Hindenburg bet against India's Adani Puzzles rival U.S. short sellers*, *Reuters*. Thomson Reuters, https://www.reuters.com/world/india/hindenburg-bet-against-indias-adani-puzzles-rival-us-short-sellers-2023-02-01/

[148] *Supra* Note 131.

[149] *Supra* Note 124.

active investors who disciplined U.S. managers at the turn of the last century.[150] Activist hedge funds hold undiversified portfolios and significant stakes in the companies that they select. Given their larger stakes and focused holdings, they are less subject to "rational apathy" and are the more efficient actor to bridge the separation of ownership and control to hold managements accountable. To better understand this concept, let's analyze what "rational apathy" really means and why it matters. As the theory goes, a rational shareholder will expend the effort to make an informed decision only if the expected benefits of doing so outweigh its costs. Given the length and complexity of proxy statements, for example, the opportunity cost of reading it before voting is quite high for an individual, but not for funds that employ several professionals.[151] Furthermore, most shareholders believe their holdings are too small to have any significant impact on the outcome, and it is so, but not for hedge funds, once again. Shareholders typically adopt the so-called Wall Street Rule: it's easier to switch than to fight.[152] Hedge funds, on the contrary, have peculiar characteristics that distinguish them from other institutional activism. First, hedge fund managers have stronger financial incentives to make profits. Hedge funds generally receive a significant proportion (e.g., 20%) of excess returns as performance fees on top of fixed management fees. Moreover, the managers of hedge funds invest a substantial amount of their personal wealth into their own funds. This type of compensation structure incentivizes managers to make large returns and, in doing so, contrasts with that of mutual fund or pension fund managers, usually unrelated to the performance. Second, hedge funds are lightly regulated since they are not widely available to the public but only to institutional clients and a limited number of wealthy individuals.[153] Therefore, hedge funds are not subject to strict fiduciary standards (such as those embodied in ERISA[154]), and this in turn allows them to have much more flexibility to intervene in the invested companies. An example is that they can use derivative securities or trade on margin to hedge or leverage their stakes with a given capital. All these characteristics represent an important advantage for activist shareholders in the fight for influence over the target firms' management.[155] Third,

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[150] *Supra* Note 124.
[151] Bainbridge, *supra* note 1, at *317-318.
[152] Chen, Brandon and Duong, Lien and Duong, Lien and Truong, Thu Phuong, *The Wall Street Rule and Its Impact on Board Monitoring* (January 24, 2018). 9th Conference on Financial Markets and Corporate Governance (2018), https://ssrn.com/abstract=3102146
[153] Alon Brav, Wei Jiang and Hyunseob Kim (2010), "*Hedge Fund Activism: A Review*", Foundations and Trends in Finance: Vol. 4: No. 3, pp 185-246. http://dx.doi.org/10.1561/0500000026
[154] The Employee Retirement Income Security Act (ERISA) protects your plan's assets by requiring that those persons or entities who exercise discretionary control or authority over plan management or plan assets, anyone with discretionary authority or responsibility for the administration of a plan, or anyone who provides investment advice to a plan for compensation or has any authority or responsibility to do so are subject to fiduciary responsibilities.
[155] *Id.*

hedge funds face fewer conflicts of interest than some other institutional investors, such as mutual funds and pension funds, who often have other business relations with the invested companies or have non-financial agendas and goals. Hedge fund managers rarely face this sort of conflict. Lastly, hedge funds usually have lock-up provisions that restrict the investors from withdrawing their principal. This feature allows managers to focus on intermediate and long/term activist objectives, considering that on average activist strategies require investing in target firms for more than a year.

Another peculiar aspect that is worth exploring is the modus operandi with which hedge funds choose their target and why. Although studies do not fully agree, many report that the typical target firm of activist investors is smaller, is more profitable, has a large institutional ownership level, and has more of a "value" orientation (namely, a higher book-to-market ratio) than a control sample of firms. But these targets are not simply "losers." Indeed, empirical studies find that the probability of a firm being targeted by an activist hedge fund is positively related to its return on assets.[156] It has been proven that over one-third of the firms targeted since 2006 actually experienced stock price over-performance prior to being targeted, and this proportion is growing over time.[157] In general, we observe that the profitability of target firms is higher than the average of the control sample, suggesting that these targets are not poorly performing firms as suggested by advocates for hedge fund activism. This last argument, if proven to be true, would justify an unrestrained intervention of funds into corporate governance. This is not the case, however, as it can also be demonstrated with evidence suggesting that target firms have lower bankruptcy risk than a control sample of non-targeted firms that are comparable by size, book-to-market, and industry.[158] To sum up, it can be derived that, although many generalizations have been advanced about the characteristics of target firms, the only generalization possible is that targets of activism often tend to have a lower Tobin's Q[159] and a "value" orientation.

[156] See Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008), https://law.duke.edu/sites/default/files/centers/gfmc/session_3/2_brav_et_al-hedge_fund_activism-2008.pdf
[157] Ajay Khorana et Al., Citigroup Global Markets, Inc., *Rising Tide of Global Shareholder Activism*, Citi Corporate and Investment Banking 7 (2013), https://www.activistinsight.com/research/Citi%20FSG%20-%20Shareholder%20Activism_250517114947.pdf
[158] *Supra* Note 144.
[159] The Q ratio, also known as Tobin's Q, equals the market value of a company divided by its assets' replacement cost. At its most basic level, the Q Ratio expresses the relationship between market valuation and intrinsic value.

Once analyzed hedge funds' core characteristics and scope of operations, it is then important to focus on the topical debate that permeated academic literature on corporate governance since the early days of Berle and Means: "does hedge fund activism create value?" Commentators typically divide the evidence into two parts based on whether the measurement period is in the short run (a few days) or the long run (a few years, usually three to five).

With respect to the shorter term, a few days before and after the filing of Schedule 13D with the SEC (defined as the "event window"), there is a general consensus that target firms earn on average positive abnormal returns, although differences exist in the studies in their definition of event windows and the economic magnitude of the abnormal returns earned.[160]
However, there are two interpretive issues with the above results. First, although it is generally true that the average stock return performance around the event date is positive, a significant proportion of firms actually earned negative abnormal returns.[161] This result validates the hypothesis that exists a significant conflict between the goals of activists and corporations. Activists typically invest in many firms concurrently, leading to positive returns on average even if only some of their targets earn substantial return performance.[162]
Corporations, on the other hand, are only invested in themselves and have neither the ability nor the luxury to diversificate. Thus, the possibility of a negative return, particularly when the upside return may be only modest, may reasonably cause a board of directors to reject a strategy favored by a group of hedge funds. The are many examples of financial disasters caused by the aggressive intervention of these actors. One of the best-known is the joint acquisition by Pershing Square and Vornado Realty Trust of over 26% of the stock of J.C. Penney. After having purchased most of the stock during the ten-day window under section 13(d), the two activists obtained board representation and forced the resignation of J.C. Penney's incumbent CEO. Although J.C. Penney's stock rose initially, customers started fleeing away from the company as a result of the "extreme makeover" pushed by the activists. J.C. Penney's stock price fell some 59.5% over the period between the initial Schedule 13D filing and Ackman's eventual resignation from the board.[163]

For what concerns the long-horizon stock return studies, opinions are divergent.

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[160] *Supra* Note 130.
[161] An abnormal return is the return generated by a security or a portfolio that exceeds its benchmark or the return predicted by an equilibrium model such as the Capital Asset Pricing Model (CAPM).
[162] *Id.*
[163] James Surowiecki, *When Shareholder Activism Goes Too Far*, NEW YORKER, Aug. 15, 2013, https://www.newyorker.com/business/currency/when-shareholder-activism-goes-too-far

Some studies, such as the one carried out by Professor Bebchuk, find that buy-and-hold stock returns are on average positive after the Schedule 13D filing. In his research, he controls for the returns on the market portfolio and the returns on small size, value and momentum portfolios (referred to as the four-factor model of stock returns). However, when the same study is conducted on the three-year and five-year calendar year returns before and after the filing date, the results appear to be statistically insignificant from zero. This suggests that an activist investor cannot beat the performance of the four-factor stock return model.[164]
A second category of studies conducted by Becht, goes beyond simply reporting the impact of the announcement of a block's formation (i.e., the filing of the Schedule 13D in the US) and focuses uniquely on the outcome of the activists' intervention. Unsurprisingly, they find that a successful outcome counts and that the market appears to value only a limited number of successful outcomes. The announcement of a takeover produced abnormal returns averaging 9.7%; the announcement of restructuring produced abnormal returns of 5.6%;
changes in board composition only yielded 4.5%; payout changes—either through dividends or stock buybacks—resulted in a negative abnormal return of -0.2%.[165]

These empirical studies provide valuable information about hedge fund activism. However, the assumption on which they are based undermines the policy arguments they advanced. Management and shareholders are seen as competitively battling for power, with shareholder interest seen as adversarial to management's objectives. This assumption leaves no room for considering that shareholders and management can work together in the interests of the company and all of its stakeholders.[166] The organization of a corporation can be viewed as an ecosystem, whose success actually rests on effective communication and collaboration between corporations and their shareholders. When a company, its management, its shareholders, and its employees work together, companies tend to be more resilient and prosperous. In turn, this benefits companies, their corporate stakeholders, and the economy as a whole. At its roots, the relationship between a company and its shareholders was based on a "mutualistic" view, in which the needs of the two categories converged. Shareholders invest their savings or capital in a company, and the company then deploys the capital to fund its operations, allowing the corporation and its shareholders' investments to grow. Additionally, this prolific corporation-

[164] Lucian A. Bebchuk et al., *Pre-Disclosure Accumulation by Activist Investors: Evidence and Policy*, 39 J. CORP. L. 1, 9 (2013), https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/6038/prediclsoure_accumulation.pdf
[165] Marco Becht et al., *The Returns to Hedge Fund Activism: An International Study* (Finance Working Paper No. 402/2014, 2015), http://ssrn.com/abstract=2376271
[166] Bamdad Attaran, *The Limits of Empirical Studies on Hedge Fund Activism* (January 15, 2022), https://ssrn.com/abstract=4098146

shareholder relationship is beneficial to a larger ecosystem. When all goes well, more employees and managers get hired, and the company produces more products or provides more services, creating value for the entire economy.[167] Unfortunately, the relationship between corporations and their shareholders may be moving away from its origins and becoming less mutualistic. This, I believe, may harm companies and their shareholders, as well as those who depend on the health of the corporation-shareholder relationship.[168]

2. Pension Fund Activism

As discussed above, institutional investors activism of the 20th century has evolved and gave birth to different forms of market participation, among those hedge funds and pension fund activism. In the previous chapter, we have discussed at length the former. Let us now turn to the latter.

Shareholder activism has taken advantage of the massive growth of worker pension funds and developed a tremendous source of power for labor. Pension funds, sometimes called labor's best capital, are invested in corporations, hedge funds, and private equity funds. This pension fund power has been used in several different ways: some of it has been employed to oppose self-serving and entrenched corporate managers and directors; some has been used directly against hedge funds and private equity funds that take working-class shareholder money and direct it against workers interests; some has been put to benefit labor directly, fending off attacks on pensions, pushing back against job losses, and creating jobs.[169] These institutional investors include anyone with a retirement account, as well as mutual funds, foundations, and socially responsible investors who may share labor's long-term investment focus and sympathize with its broad broader social goals. According to the data gathered by the Organisation for Economic Co-operation and Development (OECD), pension fund assets on a global scale exceeded USD 35 trillion at end-2020, increasing despite COVID-19 in almost all countries.[170]

Other than for their size, pension funds are distinguished for their power to operate along two dimensions: advancing workers' interests as workers and advancing workers' interests as long-

[167] *Id.*
[168] Kara M. Stein (2018) *Mutualism: Reimagining the role of shareholders in modern corporate governance*, The Harvard Law School Forum on Corporate Governance.
[169] David Webber (2018) 'Preface', in *The rise of the working-class shareholder Labor's last best weapon*. Cambridge, MA: Harvard University Press.
[170] OECD (2023), *Pension funds' assets (indicator)*. Available at: 10.1787/d66f4f9f-en

term shareholders saving for retirement. These interests are rarely considered together. They are studied in different parts of the academy, covered by different bodies of law, and serviced by different professionals and businesses who often show little awareness or understanding of the other dimension on the rare occasion when these interests are discussed together, they are portrayed as being in conflict.[171] Although that's something true, they can also be highly compatible, and mutually reinforcing. Neither interest can be understood properly without reference to the other. Furthermore, according to David Webber[172], the power of pension funds resides in one fundamental characteristic: the exploitation of market power. For far too long, he argues, labor and its progressive sympathizers have sought to transform the market from outside the market: from courts, from legislatures, from regulators, from street protests, from strikes. These tools are important. But ultimately, it is not possible to transform the market from the outside, it must be transformed from within. Because of the importance and size that capital markets have gained, pension funds need to have a voice in those contexts and deploy clever market strategies.[173]

Despite falling under the same category of shareholder activists, pension funds' activism is very different from what we have described so far for hedge funds. One aims solely at short-term profit through market speculation, the other preserves the saving of the middle and lower classes. In recent years, the two perspectives have come to a point of conflict.
Since hedge funds only invest on behalf of purportedly sophisticated investors, large institutions and "high net worth individuals", working-class shareholders could never invest in hedge funds on their own. But once aggregated into a large pension fund, worker retirement assets become legally eligible, finding their way into high-risk hedge fund investments all the same.[174] For this reason, massive sums of pension and union fund money have been invested in hedge funds. Here two problems arise. The first very practical problem, hedge funds are for investors who aspire to perform better than the S&P 500 Index. They are also supposedly vehicles for protecting investors from market downturns because they are "hedged", that is, supposedly not correlated to overall market performance. But the objective of pension funds is to bring returns in the long run without incurring too much risk, which is better done by

[171] *Supra* Note 164.
[172] Davide Webber is the author of the critically acclaimed book*, The Rise of The Working-Class Shareholder: Labor's Last Best Weapon*, published by Harvard University Press.
[173] *Id.*
[174] David Webber (2018) "The Silence of the Lions: Reigning in Hedge Funds and Private Equity", in *The Rise of the Working-Class Shareholder: Labor's Last Best Weapon*. Cambridge, MA: Harvard University Press, pp. 79–81.

indexing the market.[175] The main reason investors continue to opt for hedge funds is that some fund managers still do beat the market for short periods of time, with sometimes spectacular results. The second big issue can be summed up in the story that David Webber tells in his book. In December 2012, Dan Pedrotty[176], formerly the director of pensions and capital strategies for the American Federation of Teachers, made an incredible discovery: charter schools were now the newest trend among hedge fund managers. Charter schools are broadly defined as government-funded schools that have a mandate to operate independently from the public school system.[177] Charter schools are critiqued because some claim that such schools undermine public education by diverting resources from underfunded schools to charters that screen out the worst and most costly students, exacerbating the very problems they claim to solve. Possibly worse, the same hedge fund managers supporting charter schools, disagreeing with the AFT position to advocate for teacher pensions, thought that public school teachers were overpaid and were lobbying to cut teachers' pensions. After this discovery, Pedrotty wondered how much of their teacher retirement money was invested with these hedge fund managers. He then identified dozens of public pension funds, many of teacher funds, that were invested in hedge funds run by managers who were simultaneously lobbying to cut teacher pensions through pro-charter school organizations.[178] With the authorization of his superiors, Pedrotty started drafting a report in which the names of 33 hedge funds supporting education reform movements appeared. This "watch list" had the purpose to enable teacher pension trustees to make informed decisions about the risks their plans faced. The AFT "watch list" stunned the hedge fund community. Many hedge funds, heavily dependent on pension fund money, had to clarify their position with respect to this issue and to adjust their policies in order to be removed from the "watch list".[179]

3. Proxy Advisors' Guidelines

In this context of activism by certain institutions and rational apathy by the majority of shareholders, Proxy Advisors assume particular relevance. In fact, they represent another influential actor in the market for corporate governance.

[175] *Id.*
[176] Currently the Director of Capital Strategies at North America's Building Trades Unions.
[177] *Id.* at *85.
[178] *Id.* at *87-88.
[179] *Id.* at *89-92.

In the United States, institutional investors have opportunities annually, and often more frequently, to vote the shares they hold for their clients.[180] Institutional investors hold shares in portfolio (or investee) companies. When they vote their shares, they typically vote by proxy; that is, they send in a card on which they have marked their vote and through which they authorize a proxy agent to vote the stock as directed.[181] They often engage proxy advisors—firms such as ISS and Glass Lewis—that provide guidelines, recommendations, and other information to help investors vote their shares on the various proposals before them.[182] This is the first mechanism that conferred such wide powers to proxy advisors. In fact, institutional investors may rely on such input by proxy advisors in deciding how to cast their votes.[183] Proxy advisors may also wield influence indirectly over portfolio company managers. Corporate managers may adopt policies or make other decisions that they otherwise would not, in order to avoid opposition from proxy advisors, because they believe that investors will rely on the recommendations and other guidance provided by proxy advisors.[184] In addition to direct influence, proxy advisors may also hold sway through indirect channels. They make public pronouncements through their recommendations, guidelines, and other statements, which grab the attention of the press and shareholders. By doing this, proxy advisors influence discussions about corporate governance issues and the relative merits of business transactions, potentially influencing managers. Proxy advisors may also contribute to public companies' "publicness"—the scrutiny companies face from outside actors that interpret and frame corporate actions and that thereby influence corporate decision making.[185]

Although it is widely agreed that proxy advisors exercise influence over corporate governance, the degree to which their recommendations influence institutional investors has proved difficult to measure. Determining whether the outcome of a vote is simply correlated or directly caused by a recommendation is impossible even for the modern statistical. At one extreme, a recommendation could be just one factor among many that an institutional investor weighs in deciding how to vote; at the other extreme, an institutional investor may follow the recommendation when it would otherwise have voted differently.[186] As a consequence,

[180] See U.S. Gov't Accountability Off., Gao-17-47, *Corporate Shareholder Meetings: Proxy Advisory Firms' Role In Voting And Corporate Governance Practices* 1-5 (2016)
[181] *Id.* at *4-5
[182] *Id.* at *5
[183] Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light* (2019), 99 Boston University Law Review (2019), Washington University in St. Louis Legal Studies Research Paper No. 19-05-01, https://ssrn.com/abstract=3384264
[184] James R. Copland, David F. Larcker & Brian Tayan, *Proxy Advisory Firms: Empirical Evidence And The Case For Reform,* Manhattan Institute (2018), https://manhattan.institute/article/proxy-advisory-firms-empirical-evidence-and-the-case-for-reform
[185] *Supra* Note 168.
[186] *Supra* Note 169.

scholars reach differing conclusions on the precise influence proxy advisors have over institutional investors in the United States. The case for proxy advisors' indirect influence is perhaps more compelling. According to evidence, corporate managers may occasionally be persuaded by proxy advisors' recommendations because they think institutional investors will follow them.[187] In several corporate elections, the advice of proxy advisors has been seen as decisive. Proxy advisers' rules and practices appear to affect corporate managers' decisions since they frequently establish governance norms that are widely embraced.[188]

Many experts, such as Professor Paul Rose, see proxy advisors as "playing a significant role in directing corporate governance discourse" and, as a result, question "whether public company management is effectively being deprived of some essential latitude in how it may manage the company." There has certainly been a shift in the market for corporate influence towards these organizations, and the first restraining actions have already been undertaken.[189] In 2019, over three hundred public companies signed a letter to the SEC, calling on it to "take strong action to regulate proxy advisory firms" and referring "the large percentage of institutional voting that follows their recommendations."[190]

In this letter, the SEC was asked to address three critical frustrations regarding the current operations of proxy advisors: Conflicts of Interest, Accuracy and Transparency.

With respect to the first point, the companies advocated for strong protections for both companies and users of proxy advisory services to eliminate conflicts of interest where possible, minimize and/or mitigate them where appropriate, and disclose them to the users and subjects of reports. The solution brought forward was to disclose conflicts on the front page of proxy advisor reports on companies so that investors make fully informed voting decisions.[191]

In the second point, the companies encouraged the SEC to require transparent processes and practices that would allow all public companies to engage with proxy advisory firms on matters of mistakes, misstatements of fact and other significant disputes. This mechanism would be particularly crucial so that timely resolution of those disputes and corrections to the record could be made to minimize the negative impacts that such mistakes have on the subject company's proxy voting outreach and its shareholders. The great impact that proxy advisors have on firms' decision-making and recommendations on the capital markets and the large

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[187] Hayne, Christie and Vance, Marshall D., *Information Intermediary or De Facto Standard Setter?: Field Evidence on the Indirect and Direct Influence of Proxy Advisors* (January 1, 2019). Journal of Accounting Research, https://ssrn.com/abstract=3325622

[188] *Id.*

[189] *Supra* Note 165.

[190] Letter from Nasdaq, Inc. et al., to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (Feb. 4, 2019), https://www.sec.gov/comments/4-725/4725-4872519-177389.pdf

[191] *Id.*

percentage of institutional voting that follows their recommendations stressed the importance of identifying and correcting errors.[192]

The last point regarded the transparency of proxy voting standards: the signatories requested public transparency, including a formal public comment period, in case a proxy advisory firm intended to change its voting policies from one proxy season to the next. Furthermore, it was stated that proxy advisory firms should not be able to significantly affect voting recommendations using opaque rules. In the absence of transparent policies, neither the proxy advisory firms' clients, nor the companies they report on, can determine whether a policy is applied correctly or if a recommendation is based on factual errors.[193]

This letter was one of the numerous actions undertaken by corporations and institutional investors to require tighter rules for proxy advisors. Some of the world's biggest pension funds, like Florida's state pension fund, a prominent hedge fund (Elliot Management Corp.), and mutual fund firm Aberdeen Standard Investments are among those pushing to put proxy advisers on a tighter leash.[194]

Since proxy advisors retain all this power in the corporate governance context, their opinion on certain matters is to be carefully examined. Proxy advisors' guidelines concerning poison pills, for instance, are contained in their policy updates for 2023. In these reports, they make clear that they believe that poison pills are generally not in shareholders' best interests.[195] Glass Lewis states that rights plans can reduce management accountability by substantially limiting opportunities for corporate takeovers and thus prevent shareholders from receiving a buy-out premium for their stock.[196] According to their reports, shareholders should vote against these plans to protect their financial interests and to ensure they have an opportunity to consider any offer for their shares, especially those at a premium.[197] GlassLewis' opinion on the full matter is expressed in these lines: "We believe boards should be given wide latitude in directing company activities and in charting the company's course. However, on an issue such as this, […], we believe that shareholders should be allowed to vote on whether they support such a

[192] *Id.*
[193] *Id.* at *2.
[194] Jessica DiNapoli and Svea Herbst-Bayliss (2019) *Pension and hedge funds push U.S. Sec to reconsider proxy adviser guidance*, *Reuters*. Thomson Reuters, https://www.reuters.com/article/sec-investors-idINL2N26Z0SH
[195] Cydney S. Posner (2022) *ISS issues benchmark policy updates for 2023*, *The Harvard Law School Forum on Corporate Governance*, https://corpgov.law.harvard.edu/2022/12/23/iss-issues-benchmark-policy-updates-for-2023/
[196] *United States - Glasslewis.com* (2022) *2023 Policy Guidelines United States*. Available at: https://www.glasslewis.com/wp-content/uploads/2022/11/US-Voting-Guidelines-2023-GL.pdf?hsCtaTracking=45ff0e63-7af7-4e28-ba3c-7985d01e390a%7C74c0265a-20b3-478c-846b-69784730ccbd
[197] *Id.*

plan's implementation. This issue is different from other matters that are typically left to board discretion. Its potential impact on and relation to shareholders is direct and substantial. It is also an issue in which management interests may be different from those of shareholders; thus, ensuring that shareholders have a voice is the only way to safeguard their interests."[198] Highlighting the criticality of the issue, proxy advisors take a strong position against pills and their unconditioned use by BoDs.

ISS' position is well in line with that of its analogous institution and recommends votes against all nominees (except new nominees, who should be considered case-by-case) if: the company has a poison pill with a dead-hand or slow-hand feature; if a short-term pill with a dead-hand or slow-hand feature is enacted but expires before the next shareholder vote; the board makes a material adverse modification to an existing pill, including, but not limited to, extension, renewal, or lowering the trigger, without shareholder approval; or the company has a long-term poison pill (with a term of over one year) that was not approved by the public shareholders.[199] Moreover, a case-by-case vote is recommended on nominees if the board adopts an initial short-term pill (with a term of one year or less) without shareholder approval, taking into consideration: the disclosed rationale for the adoption; the trigger; the company's market capitalization (including absolute level and sudden changes); a commitment to put any renewal to a shareholder vote.[200]

[198] *Id.* at *69.
[199] *United States - Proxy Voting Guidelines 2023* (2022) *https://www.issgovernance.com/policy-gateway/voting-policies/.* Available at: https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf?v=1
[200] *Id.*

IV. ANTI-ACTIVIST POISON PILLS

Although, as we've seen, poison pills were devised to defend corporations from the threat of takeovers, they have evolved to perform a modern function: protect companies from misplaced shareholder activism. In this chapter, we will examine the issue emerged from the intersection of two previously described phenomena: the transformation of the poison pill from a takeover defense to a more widely used corporate law device; and the evolving role of shareholders—activist, institutional, and other—in corporate governance. In the current context, in which institutional investors are *de facto* becoming "deciders" of corporate governance, it becomes crucial to understand the role of poison pills. Furthermore, many design features of the pills now start to matter in the debate for their legitimacy. While in takeovers, the bidder's primary gains came from acquiring the company and improving it, in activism contexts, bidders profit from an increase in the value of their stakes in the target.[201] Settling the legitimacy of anti-activist poison pills is of particular importance at this time because it will determine the impact of ESG activists on corporate governance.[202]

The last few years witnessed a rise in stakeholder governance, environmental, social, and governance (ESG) factors, which encompass issues ranging from diversity and human rights to climate change and sustainability.[203] ESG has quickly risen to the top of boardroom and shareholder agendas.[204] Amid the ongoing COVID-19 pandemic, the 2021 proxy season saw more ESG-focused shareholder proposals—and support of those proposals—than ever before.[205] And on the corporate side, an increasing number of companies are embracing ESG issues "as a strategic business imperative." At the end of the 2020 proxy season, a record 90% of S&P 500 companies published an ESG report, an increase from 20% a decade ago.[206] Most experts today agree that ESG is a desirable force. And even for those who question the value

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[201] Marcel Kahan & Edward Rock, *Anti-Activist Poison Pills*, Boston University Law Review (2019), https://www.bu.edu/bulawreview/files/2019/06/KAHAN-ROCK.pdf

[202] Caley Petrucci and Guhan Subramanian, *Pills in a World of Activism and ESG* (2022). The University of Chicago Business Law Review (2022), https://ssrn.com/abstract=4104799

[203] Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future* (2019). U of Penn, Inst for Law & Econ Research Paper No. 19-39, Harvard John M. Olin Discussion Paper No. 1018 https://ssrn.com/abstract=3461924

[204] Russ Banham (2019) *Board action on ESG needed to ensure long-term performance gains*, Forbes, https://www.forbes.com/sites/insights-kpmg/2019/12/10/board-action-on-esg-needed-to-ensure-long-term-performance-gains/

[205] PwC's 2021 Annual Corporate Directors Survey, PWC, https://perma.cc/4YS7-246K

[206] Anthony Garcia, Jennifer Grzech, and Peter Reali, (2021) *ESG: Investors increasingly seek accountability and outcomes*, The Harvard Law School Forum on Corporate Governance, https://corpgov.law.harvard.edu/2021/04/25/esg-investors-increasingly-seek-accountability-and-outcomes/

of ESG considerations in for-profit corporate structures, there is no doubt that ESG will be with us for the foreseeable future. Stockholder activism and ESG interact in meaningful ways. While traditional activism focuses on short-term profit and total shareholder return, the rise of ESG has brought with it a new set of activists concerned with ESG-related issues. Modern activism includes dual-purpose activists who combine shareholder-return and ESG arguments, as well as "pincer attacks" from ESG and shareholder-return activists acting independently or in concert against the same company.[207]

A. PROPOSAL OF A DIFFERENT STANDARD OF REVIEW

Now that we have established the importance of the debate regarding anti-activist poison pills, not just for the sake of research but also to forecast future developments in the corporate governance context, we move to the next issue. That is the choice of the appropriate standard of review for a pill like William's one. That pill, enjoined by the court for its extreme features, represents a milestone in the anti-activist pills literature. Some commentators such as Professor Jeffrey N. Gordon[208] argue that the very point of that activist pill is to disrupt the possibility of a proxy contest and therefore any activist shareholder power. For this reason, it should be treated differently from all pills that are scrutinized under the Unocal test.[209]

Professor Gordon claims that the original "poison pill" has been repurposed: once designed to restore the structural status quo in the board's plenary power to vet and approve mergers, it has now assumed the purpose to obstruct the ability of a shareholder activist.[210] "The goal of the anti-activist pill is to preclude challenges to the board's power. This is vote suppression, corporate style. Under current conceptions of Delaware law, it cannot stand", he holds.[211] According to his study, not only Chancellor McCormick was surely right that The Williams Company pill fails under *Unocal* as a disproportionate response, but also, *Blasius* would be the right standard of review. This pill, in fact, "represents action taken for the primary purpose of interfering with the exercise of the shareholders' right to elect directors". In *Blasius*, two separate cases pitting the directors of Atlas Corp. (defendant) against its largest shareholder,

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[207] Andrew R. Brownstein, *et al.* (2021) *The ESG/TSR activist 'pincer attack'*, The Harvard Law School Forum on Corporate Governance, https://corpgov.law.harvard.edu/2021/01/26/the-esg-tsr-activist-pincer-attack/
[208] *Supra* Note 75.
[209] *Supra* Note 76.
[210] *Id.*
[211] *Id.*

Blasius Indus., Inc. (plaintiff), were consolidated and tried together. The decision is notable not only because it is one of the only examples where a Delaware court determined that the "compelling justification" standard was satisfied, but also because the Court articulated a new standard of review – a modified form of the *Unocal* reasonableness standard of review – to evaluate actions influencing the outcome of corporate director elections or other stockholder votes having consequences for corporate control.[212]

Other commentators disagree with this idea and reaffirm Unocal as the appropriate standard of review for pills, even in the case of anti-activist pills. One of them is Eric S. Robinson[213]. In his response to Gordon, he contends that it is "settled law" that *Unocal* is the appropriate standard to assess the board's adoption of a poison pill and its refusal to redeem it.[214] He bases his reasoning on two grounds. First, there was no need or precedent for the court to apply the "compelling justification" standard under *Blasius* to rights plans. Second, as the late Chancellor William Allen, the *Blasius* author himself, has written, *Blasius* is not so much a standard of review as a response triggered by intentional disenfranchisement.[215] By contrast, the *Unocal* two-prong test exposes whether the motives underlying a defensive measure are legitimate and whether the measure is reasonable. Thus, the Chancery Court has properly applied *Unocal* to strike down actions that unreasonably intruded upon stockholder voting rights in some cases, while in others finding that voting schedule adjustments, poison pills, and other defensive actions were reasonable measures.[216] He concludes that when applied properly, as in *The Williams Companies*, the *Unocal* test addresses the concerns that Gordon seeks to use *Blasius* to remedy.

B. REASONABLE THREATS

Having settled that Unocal is the most appropriate standard of review for pills, even anti-activist pills, we shall consider the two-step enhanced scrutiny to determine whether poison pills are still a valid device in the corporate governance context. Generalizing what we learned

[212] See Blasius Industries, Inc. v Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988) (Allen, Ch.)
[213] Eric S. Robinson is of counsel in Wachtell, Lipton, Rosen & Katz's Corporate Department, focusing principally on corporate mergers and acquisitions.
[214] Eric S. Robinson (2021) *The anti-activist pill in the Williams Companies Stockholder Litigation: A response to Professor Gordon*, CLS Blue Sky Blog, https://clsbluesky.law.columbia.edu/2021/09/01/the-anti-activist-pill-in-the-williams-companies-stockholder-litigation-a-response-to-professor-gordon/
[215] *See* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1312 (2001), https://www.jstor.org/stable/40688020
[216] *Supra* Note 206.

previously for the Williams Case, the scrutiny under Unocal requires the identification of a threat and the assessment of the proportionality of the response.

1. Mistaken Belief

One of the most obvious threats posed by an activist is that even though, in the assessment of the board and its advisors, the activist's proposals are not in the best interest of shareholders, shareholders may nevertheless support the activist because they mistakenly believe otherwise. Delaware courts have consistently promoted the idea that a decision by shareholders to vote against what the board believes is best does not pose any cognizable threat.[217] To cite Chief Justice Strine: "The notion that directors know better than the stockholders about who should be on the board is no justification at all."[218]And as a recent Chancery Court opinion echoed, "[T]here is one justification that the directors cannot use to justify their actions: they cannot argue that without their intervention, the stockholders would vote erroneously out of ignorance or mistaken belief about what course of action is in their own interests."[219] The rationale dates back to the landmark previously mentioned opinion in Blasius Industries Inc. v. Atlas Corp[220]. That is, as long as shareholders are provided with full information and the vote is free from structural flaws such as coercion, a board's determination that shareholders are likely to vote "the wrong way" is not a legitimate basis for taking defensive measures.

2. Disruption

Another arguable threat is that an election contest, and the actions of the activists, cause disruption in the operation of the target. An example of this can be found in Third Point LLC v. Ruprecht[221]. In its decision, the court noted that the fund manager Loeb, whose hedge fund had taken a stake in Sotheby's, acted in an "aggressive and domineering manner"[222] and represented himself as the person who 'was going to be appointing management in the

[217] *Supra* Note 16.
[218] Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 811 (Del. Ch. 2007).
[219] Pell v. Kill, 135 A.3d 764, 788 (Del. Ch. 2016)
[220] *Supra* Note 204.
[221] No. 9469-VCP, 2014 WL 1922029 (Del. Ch. May 2, 2014).
[222] *Id.* at *22.

future."[223] This behaviour logically raised concern among potential clients about the stability of Sotheby's. In that instance, it was established that to reassure stakeholders who feel insecure, it may be justifiable to adopt reasonable measures, such as "tin" parachutes for lower-level employees or long-term contracts for key suppliers.[224] However, despite the potential harm to the company, this threat cannot justify poison pills. Activists must be permitted—in fact, they should be encouraged—to state their business plans. If these plans scare the company's employees, customers, suppliers, and others, this is the unavoidable consequence of corporate democracy. A board cannot be permitted to adopt a measure that has the principal effect of handicapping a disruptive activist without undermining corporate democracy.[225]

3. The "Short-Termism" Problem

In the policy debate, a principal charge levelled against shareholder activism is that it contributes to "short-termism." The problem became evident when Hedge funds criticized Apple's large retained earnings in 2013. As Martin Lipton remarked, it was foolery to see one of the most successful, long-term-visionary companies of all time being told by a money manager that Apple was doing things all wrong and should have focused on short-term return of cash. Real Shareholders' power was being harnessed by activist funds that looked through SEC filings looking for opportunities to demand a change in a company's strategy to create a short-term profit.[226] In the face of these pressures, more and more corporate leaders have responded with actions that can deliver immediate returns to shareholders, such as buybacks or dividend increases. Focusing on short-term causes underinvesting in innovation, skilled workforces, or essential capital expenditures necessary to sustain long-term growth. The short-termism concern was also supported by prominent characters such as Chief Justice Strine. He wondered: "Why should we expect corporations to chart a sound long-term course of economic growth, if the so-called investors who determine the fate of their managers do not themselves

[223] *Id.* at *11.
[224] Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577 (2003), https://www.jstor.org/stable/3313031
[225] *Supra* Note 16.
[226] Martin Lipton, Wachtell, Lipton, Rosen & Katz, *Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (2013), https://corpgov.law.harvard.edu/2013/02/26/bite-the-apple-poison-theapple-paralyze-the-company-wreck-the-economy/

act or think with the long term in mind?”[227] The debate as to whether hedge fund activism creates or not value, in the long run, is still unsettled. However, it is certain that the high-profile concern that activist hedge funds are pursuing short-term agendas at the expense of long-term value creation is the wind in the sails of efforts to implement and expand anti-activist measures.[228] The inquiry arising from this scenario is whether the “short-termism” concern is a threat that justifies an anti-activist pill adoption.

The answer is no. For two reasons. First, on one level, the “short-termism” argument just particularizes the concern that shareholders will cast votes in a mistaken assessment of their own best interest: that is, shareholders undervalue long-term benefits.[229] According to that line of reasoning, shareholders who favor short-termism are hurting themselves as much as they are hurting their fellow shareholders. While this is a valid argument in the court of public opinion, it is not a proper factor to take into account in justifying a poison pill.[230] The second reason is that the “pump-and-dump” scheme is highly unlikely to be repeated several times because it would require shareholders to be fooled over and over again. The “pump-and-dump” scheme is the behaviour that hedge funds engage in for which they accumulate stock, obtain control, change the corporate strategy, exit at a profit, and leave the other shareholders with losses that will accrue in the future. If the stock price does not rise with the disclosure of the activist’s investment, it eliminates the “pump.”[231]

4. Acquiring Creeping Control

Another justification for a pill is that an “activist” may be trying to acquire control incrementally and without paying a control premium (“creeping control”). The transition from a dispersed shareholding to a controlling one is particularly significant in corporate law and a special scrutiny is devoted to it.[232] From this perspective, the fact that an activist may have started to wage, or may contemplate waging, a proxy contest, is incidental. A proxy contest is not per se relevant to the threat of acquiring creeping control; it merely calls for increased care

[227] Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?,* 66 BUS. LAW. 1, 1-2 (2010), https://www.jstor.org/stable/25758524
[228] Bernard S. Sharfman, *Activist Hedge Funds in a World of Board Independence: Creators or Destroyers of Long-Term Value?* (2015). Columbia Business Law Review, p. 814, 2015, https://ssrn.com/abstract=2576408
[229] *Supra* Note 16.
[230] See *Supra* Section 1 “Mistaken Belief”.
[231] *Supra* Note 16.
[232] Paramount Commc’ns Inc. v. QVC Network Inc., 637 A.2d 34, 42 (Del. 1994).

as the board may use a purported threat of acquiring creeping control to fend off a bothersome proxy challenge. Indeed, the are two seminal cases regarding the threat of creeping control. In these instances, the threat was deemed valid to adopt a defensive pill. In Yucaipa American Alliance Fund II, L.P. v. Riggio[233], Yucaipa, a hedge fund run by Ronald Burkle, had acquired a 17.8% stake in Barnes & Noble. At about the same time, Aletheia Research and Management, a hedge fund with a history of following Yucaipa's lead, had increased its stake from 6.37% to 17.44%.[234] In response, the company adopted a poison pill with a 20% trigger while grandfathering the 30% stake held by Leonard Riggio, Barnes & Noble's founder.[235] In rejecting Burkle's challenge that the pill interfered with his ability to mount a proxy contest, then-Chancellor Strine's opinion highlighted the concern that Yucaipa may acquire creeping control.[236] The court noted that Yucaipa's claim that it posed no control threat was undermined by the fact that its 13D disclosures indicated that it may acquire as much as 50% of Barnes & Noble. This case was cited in the Williams process, but the court rejected it because "nothing in Yucaipa validates a general concern regarding stockholder activism".[237]

In a second case, Third Point LLC v. Ruprecht, two activist hedge funds (Marcato and Third Point) had acquired significant ownership positions in Sotheby's and filed disclosures using Schedule 13D. Unhappy with Sotheby's management, they vigorously pushed for change.[238] In response, in October 2013, Sotheby's board adopted a poison pill with a 20% trigger for investors who did not seek a change in control (Schedule 13G filers) and a 10% trigger for all others. When Third Point sought injunctive relief, Vice Chancellor Parsons found that "Third Point posed a threat of forming a control bloc for Sotheby's with other hedge funds without paying a control premium."[239] This confirms that a threat of creeping control justifies the adoption of the pill.

5. Preserving a Fair Election Process

One final potential justification for an "anti-activist" poison pill is that it results in a fairer process in the upcoming board election, where a "fair election process" is one in which the side

[233] Yucaipa American Alliance v. Riggio, 1 A.3d 310 (Del. Ch. 2010).
[234] *Id.* at 324.
[235] *Id.* at 321.
[236] *Id.* at 359-60.
[237] *Supra* Note 53.
[238] Third Point LLC v. Ruprecht, No. 9469-VCP, 2014 WL 1922029 at *6.
[239] *Id.* at *17.

with the better argument prevails. In this case, an anti-activist pill is actually a neutral device rather than a device specifically intended to impede activists. The board of directors, in line with its duty to oversee the business and affairs of the corporation, can plausibly view the decision-making process as a fundamental strategic mechanism through which the better argument prevails.[240] A board should be allowed to do so as long as it acts in good faith and in an unbiased manner. Furthermore, this goal of channelling critical corporate decisions through a fair election process has deep roots in Delaware law. It underlies the regulation of hostile takeover bids.[241] The validity of a poison pill means that, in the hostile takeover context, a decision by a majority of shareholders to tender into a noncoercive bid is not sufficient to permit the bid to go forward, but requires that the bidder win a proxy contest for control, a potentially more deliberative process than a tender offer.[242] If a board can opt to channel the control contest through an election process, it is a short step to conclude that the election process itself should retain substance by enabling a board to prevent gross imbalance in the electoral stakes of the contestants. The notion of fair process ensured by the board is articulated in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.[243] as applied to takeover battles. Revlon and subsequent cases have held that when a company is in Revlon mode and faced with competing bids, the board must be “most scrupulous” in “adhering to ordinary standards of fairness,”[244] may not “play favorites,” and is highly constrained in affording different treatment to bidders. These elements make this last threat one of the most credible and defendable when justifying the adoption of a pill.

C. PROPORTIONAL RESPONSES

The “threat” analysis is only the first step of the Unocal analysis. The second step, just as important, is the assessment of the proportionality to the threat posed. An anti-takeover pill is generally proportionate as long as the board reasonably believed that the price of an acquisition offer was inadequate and the pill permits the bidder to replace the board, in the ordinary course, through a proxy contest and have the new board redeem the pill. In the

[240] Edward B. Rock, *Shareholder Eugenics in the Public Corporation* (2012). Cornell Law Review, Vol. 97, Pg. 849, 2012, U of Penn, Inst for Law & Econ Research Paper No. 11-26, https://ssrn.com/abstract=1910681
[241] Morgan White-Smith, *Revisiting Revlon: Should Judicial Scrutiny of Mergers Depend on the Method of Payment*? The University of Chicago Law Review 79, no. 3 (2012): 1177–1214. http://www.jstor.org/stable/23317733.
[242] *Id.*
[243] Revlon, Inc. v. MacAndrews & Forbes Holdings 506 A.2d 173 (Del. 1986).
[244] Mills Acquisition Co. v. MacMillan Inc., 559 A.2d at 1264.

takeover context, then, the very ability to run a proxy contest is what renders a pill reasonable. For an anti-activist pill, the calculus must be different. Because an activist depends on an economic stake in the target to provide it with economic incentives and credibility to wage a proxy contest, many more design features of the pill bear on the practical ability to run a proxy contest than in the takeover context. Because an anti-activist pill that is too strong is not rendered more reasonable by the ability to replace the board and have the new board redeem the pill, it is necessary for courts to scrutinize these design features to assure that they constitute reasonable responses to a threat.[245] Even design features that have long been elements of anti-takeover pills, and have raised no controversy in this setting, may be unreasonable in pills directed against activists. However, because of their characteristics, these pills have to assessed on a case-to-case basis and no general proportional pill can be identified.

[245] *Supra* Note 19.

V. CONCLUSIONS

Shareholder activism is shaping modern corporate governance. Although the debate on the outcome of certain types of activism is still open, this force cannot be ignored or silenced. It is and will continue to be a way in which corporations can successfully navigate the multiple pressures of a complex world. Two factors will likely increase the barriers to the adoption of poison pills, especially anti-activist ones. First, is the position of proxy advisors. Even though tighter requirements will preferably be applied to them in the future, they have become widely influential, and they now impact the corporate world significantly. They have taken a stance against poison pills because they perceive them as a form of entrenchment rather than shareholder protection. Second, the heritage of the Williams' Litigation. This case showed the rigor with which the standard of review will be applied to poison pills and showed the weakness of a pill with extreme features. It is expected that the standard of review will remain unchanged, although some proposals have been made, and the two prongs will continue serving as an authority for the matter. Activist hedge funds, proxy advisors, and Delaware courts are critical of activist pills. Either one or all of them will be successful in undermining these devices.

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