

## RiskMetrics Revises Poison Pill Policy; On-the-Shelf Rights Plans on the Rise

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Public company boards of directors that adopt or renew a shareholder rights plan (also known as a “poison pill”) without seeking shareholder approval will face additional investor scrutiny beginning in 2010. The influential proxy advisory firm RiskMetrics Group recently released updates to its proxy voting recommendation guidelines for 2010 that will increase the frequency with which RiskMetrics will recommend a vote against directors for adopting or renewing most non-shareholder approved rights plans. Under these revised voting guidelines, RiskMetrics will recommend that its clients vote against or withhold from all director nominees (except new nominees) of companies that adopt a shareholder rights plan with a term greater than one year, or that renew any shareholder rights plan (including with a term of one year or less), without seeking shareholder approval.

### Analysis of RiskMetrics’ New Policies

Under its previous voting guidelines, RiskMetrics would limit its against or withhold vote recommendation with respect to non-shareholder approved rights plans to the annual meeting following adoption or renewal of the rights plan. However, under its new guidelines, RiskMetrics will revisit whether a company has a non-shareholder approved rights plan at least once every three years for companies with annually elected directors for purposes of this withhold/against vote recommendation. Furthermore, for companies with a classified board of directors, RiskMetrics will recommend a vote against director nominees standing for election each year following the adoption or renewal of a non-shareholder approved rights plan. This new policy will apply to companies that adopt or renew a shareholder rights plan after November 19, 2009. Although this revised policy will not initially apply to companies that adopted or renewed a shareholder rights plan on or prior to November 19, 2009, RiskMetrics has indicated that “in future years, it is possible that the policy will be applied retroactively to companies that previously adopted long-term pills.”<sup>2</sup>

RiskMetrics’ policy change on reviewing non-shareholder approved rights plans reflects recent trends in the adoption and terms of shareholder rights plans. Traditionally, shareholder rights plans almost always had a term of ten years. In recent years, however, as sentiment against shareholder rights plans (particularly those with longer terms) has increased from shareholder activists and institutional shareholders, rights plans with terms of three years or less have become much more common than in the past. Under RiskMetrics’ previous policy, companies could adopt non-shareholder approved rights plans with a longer term and try to withstand the negative consequences of RiskMetrics’ withhold/against vote recommendation at the next annual meeting rather than having to revisit the issue in subsequent years. The change in RiskMetrics’ policy means that adopting or renewing a shareholder rights plan with a longer term will not limit the frequency with which a rights plan will draw scrutiny from RiskMetrics. Therefore, companies without a rights plan or with a rights plan about to expire should note the potential impact on director elections of adopting or renewing a plan without shareholder approval, especially if the company has majority voting for directors and/or a classified board.

RiskMetrics also revised its policy to provide that it will not automatically recommend a withhold vote for nominees of companies that adopt a new rights plan with a duration of one year or less (as under RiskMetrics’ previous voting guidelines), but instead will review these nominees on a case-by-case basis. The change in this policy will allow companies that are “in play” to adopt a rights plan with a term of one year or less without obtaining shareholder approval, and apparently reflects a recognition from RiskMetrics that the adoption of a rights plan in the midst of a takeover battle may augment shareholder value by increasing a board’s leverage (as reflected in certain previous academic studies).<sup>3</sup>

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<sup>2</sup> RiskMetrics Group, *U.S. Corporate Governance Policy 2010 Updates* (November 19, 2009) at 7.

<sup>3</sup> RiskMetrics’ *U.S. Corporate Governance Policy 2010 Updates* states that “shorter term pills . . . may in some cases provide the board with a valuable tool to maximize shareholder value in the event of an opportunistic offer.” *Id.*

## **The Rise of On-the-Shelf Rights Plans**

Rather than adopting or renewing a shareholder rights plan, an increasing number of U.S. public companies have prepared shareholder rights plans "on-the-shelf."<sup>4</sup> In this scenario, a company does not legally adopt a shareholder rights plan, but instead prepares and reviews a form of shareholder rights plan that can be quickly approved by the company's board in the event a threat emerges or a significant shareholder engages in coercive or abusive actions. A company that puts a plan on the shelf does not legally adopt a shareholder rights plan or make any public disclosure regarding this action. Therefore, the company avoids (or at least defers) a RiskMetrics' withhold recommendation and negative shareholder reaction that may follow the company's adoption of a plan. This approach allows companies to adopt a plan on very short notice if a threat arises, and also allows boards to consider the terms and merits of a plan in a more deliberate manner outside the fog of a takeover battle or an overt activist campaign.

There are certain limitations with respect to on-the-shelf rights plans in comparison to formally adopting a shareholder rights plan. On-the-shelf plans do not prevent rapid open market or block purchases that might occur prior to the time at which a plan can be legally adopted. Moreover, an on-the-shelf plan does not deter abusive wolfpack behavior by shareholders that might be deterred if a rights plan were in effect at that time. Nevertheless, we believe that these limitations do not significantly undermine the efficacy of on-the-shelf rights plans in most cases, and advise that public companies without a shareholder rights plan consider whether an on-the-shelf rights plan should be a part of the company's takeover preparedness.

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<sup>4</sup> Although there are no statistics publicly available regarding the frequency with which U.S. public companies have prepared rights plans "on-the-shelf" as the result of the fact that no public disclosure is made regarding this action, as an anecdotal matter we believe that the number of companies preparing on-the-shelf rights plans has significantly increased as of late.