

Locke Lord QuickStudy: Delaware Court of Chancery Reminds That Rights Plans Have Limits

WRITTEN BY

Stanley Keller

The Delaware Court of Chancery, in *The Williams Companies Stockholder Litigation*, 2021 WL 754593 (Del. Ch. Feb. 26, 2021), struck down a shareholder rights plan (commonly known as a “poison pill”) adopted by The Williams Companies, Inc. at the outset of the pandemic that depressed the energy industry in order to forestall possible activist attacks. By invalidating the Williams rights plan, the Court reminds companies that, while a recognized defensive measure to be appropriately employed, shareholder rights plans interfere with the ability of shareholders to fully exercise their fundamental rights and, therefore, the provisions of the plan must pass muster as reasonably related to the threat to the company and the process followed and record made in adopting it must establish that reasonableness.

Background. Williams is a publicly-held energy company in the natural gas industry. In early 2020, after the COVID-19 pandemic was declared a national public health emergency, the Williams stock price fell sharply. After international oil prices dropped following an OPEC price war, the Williams stock price fell further. This stock price decline caused concern at Williams that it could be a target for activist actions. Williams had prior experience dealing with activists who tried to gain a controlling influence and pursue a short-term agenda. To combat the threat of new activist attacks, the Williams board, with input from outside advisers, acted quickly to adopt a shareholder rights plan aimed at preventing such attacks. The plan, which had a one-year term, had several aggressive features as described below.

Adoption of the rights plan received negative market and stockholder reaction, and lawsuits were filed to enjoin the plan based on claims of breach of fiduciary duty by the Williams directors in adopting the plan. In reaching its decision, the Delaware Court of Chancery applied the two-part *Unocal* standard, looking first at whether the board “had reasonable grounds for concluding that a threat to the corporate enterprise existed,” and then at whether the defensive measures were “reasonable in relation to the threat posed.” The Court determined that this standard was not met in this situation and invalidated the rights plan and enjoined its continued operation.

Substantive Provisions. The Williams rights plan had several substantive provisions that troubled the Court, which characterized the plan as “unprecedented” in having “a more extreme combination of features than any pill previously evaluated by this court.” First, the plan established an aggressive 5% beneficial ownership trigger threshold. This threshold was lower than the 10% to 15% thresholds typically used (apart from plans designed to protect net operating losses as tax assets) and lower than any general rights plan approved by the Delaware courts. The Court expressed concern over use of this low a trigger threshold absent clear circumstances justifying it.

Next, the plan included an expansive concept of “acting in concert” to aggregate stockholders as a “group” designed to prevent activist “wolfpacks,” but which the Court found could have swept in stockholders exercising their normal rights as stockholders without even collaborating with those targeted by the plan. Relatedly, the “passive investor” exclusion was so narrow, even more limited than the “passive investor” exclusion under Section 13(d) of the Securities Exchange Act of 1934, that it would not have excluded these types of ordinary stockholders from being subject to the severe consequences of triggering the rights plan.

The Court found that, taken together, the Williams rights plan exceeded what is permissible in the absence of a strong showing that the plan was reasonably related to addressing an actual threat, which Williams failed to show.

Procedural Considerations. In addition to concerns over the substantive provisions of the rights plan, the Court found the process followed in adopting it to be deficient. Despite various procedural steps taken by the Williams board, the Court questioned their adequacy. For example, the Court noted that the board never discussed the plan’s key features and, while the minutes recited the usual justifications for typical rights plans, they failed to address this specific unique situation and the actual motivations behind adoption of the plan.

These deficiencies gave the Court leeway to determine the true motivations and whether they represented actual threats justifying adoption of the Williams plan. The Court identified the board’s generalized concerns over activist threats and short-termism, but was not willing to go so far as to recognize these “hypothetical” threats as justification for adoption of a rights plan. The Court also identified the board’s concern over filling the gap left under the federal disclosure regime under Section 13(d) of the Securities Exchange Act by blocking undetected rapid stock accumulations. However, without determining whether that could be a sufficient justification, it found that the Williams board “failed to show that this extreme, unprecedented collection of features bears a reasonable relationship to their stated corporate objective” and therefore that the rights plan was invalid.

Lessons to be Learned.

- Triggering thresholds in shareholder rights plans commonly used and previously upheld by courts are more likely to be sustained. To the extent a more aggressive approach is taken, the justification for it will need to be greater.
- Aggregation provisions, such as “group” and “acting in concert” concepts, have been upheld, but they and related exclusions need to be drafted with care to avoid being broader than justified and sweeping in stockholders who are not part of the targeted group.
- Process continues to be important, which includes establishing a good official record, and shareholder rights plans should not be treated as routine. The more aggressive the plan, the more effort should be made to justify its provisions and to establish a record of careful consideration, including the threats being addressed and the reasons for particular provisions to address those threats.
- Most importantly, the *Williams* decision does not undermine the valid use of shareholder rights plans, but, in recognizing them as an available defensive measure, emphasizes the importance of their being done carefully and correctly. If anything, the decision underscores the benefit of companies having a carefully considered rights plans “on-the-shelf,” ready to be implemented if and when needed, and reviewing it regularly so that it is kept current.

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