

# COVID-19: Impact on M&A and Shareholder Activism

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# What Are We Seeing and Hearing?

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## ▪ **Widespread pause to M&A activity**

- With 2020 already off to a sluggish start relative to 2019, COVID-19 has caused many pending deal discussions to slow down (or go pencils down) to allow the market/economic situation to become clearer
- Unlikely to see new M&A processes kick off for the time being (although reduced equity valuations and disruptions may trigger some to seek to take advantage)
- Also seen examples of deals being pulled
  - Five months after offering to buy HP, Xerox suspended its \$36 billion hostile takeover bid on March 13, 2020, citing the escalating COVID-19 pandemic; subsequently, on March 31, Xerox withdrew its hostile bid and attempt to secure seats on HP's board, stating "[t]he current global health crisis and resulting macroeconomic and market turmoil caused by COVID-19 have created an environment that is not conducive to Xerox continuing to pursue an acquisition of [HP]"
  - On March 17, 2020, Public Storage dropped its \$1.27 billion offer to acquire National Storage REIT due to the outbreak of COVID-19 and its effect on market conditions
  - On April 6, 2020, airplane component makers Woodward and Hexcel announced they mutually agreed to abandon their \$6.4 billion stock-for-stock merger "in response to the increasing impact on both the aerospace and industrial sectors, and global markets broadly, resulting from" COVID-19

## ▪ **Regulatory delays to pending M&A deals**

- With regulatory agencies dealing with same "work from home" and other constraints as the private sector, timing of regulatory approvals are no longer as predictable
  - Waste Management announced on March 18, 2020, that its planned \$4.9 billion merger with Advanced Disposal Service cannot close as originally anticipated due to COVID-19 delays impacting the DOJ's antitrust review
- HSR early termination available after initially being suspended (effective March 30), but on a more limited basis
  - Will be granted more slowly and in fewer cases for the duration of the pandemic

## ▪ **Questions on whether debt financing sources will underwrite new financing commitments; seller and buyer anxiety that committed financing may not actually be available when time comes to close**

## ▪ **R&W insurers are focused on COVID-19's impact on claims, seeking exclusions for COVID-19-related risks**

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# What Are We Seeing and Hearing?

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## ▪ Buyers evaluating their options under signed M&A agreements

- Sycamore Partners is seeking to terminate its agreement to acquire 55% of Victoria's Secret, alleging L Brands (Victoria's Secret's parent company) (i) breached its obligation to operate in the ordinary course, (ii) breached various reps and warranties such that closing conditions will not be satisfied and (iii) suffered a Material Adverse Effect
  - Alleged IOC Breaches: Furloughs / reductions in employee compensation, failure to bring in new inventory, and missed rent payments (among other things)—all actions taken by L Brands in response to COVID-19
  - Alleged MAE: Although the transaction agreement excluded the impact of pandemics in determining whether Victoria's Secret experienced an MAE, the pandemic exception did not apply to effects that “would prevent, materially delay or materially impede the performance by [L Brands] of its obligations” under the agreement
- BorgWarner provided notice to Delphi Technologies that Delphi's \$500 million credit facility draw breached the interim operating covenants under the parties' January agreement
  - Delphi claims that BorgWarner unreasonably withheld its consent to draw down on the revolver
- 1-800 Flowers refused to close on its acquisition of Bed Bath & Beyond's PersonalizationMall.com on March 30, 2020, despite Bed Bath & Beyond's assertion all conditions to closing were satisfied, indicating a March 30<sup>th</sup> closing was “commercially impracticable” and it was assessing whether COVID-19 gave rise to a Material Adverse Effect or prevented PersonalizationMall.com from “operating consistent with past practice”
  - Bed Bath & Beyond brought suit in the Delaware Court of Chancery to cause 1-800 Flowers to close on the transaction

## ▪ Cash-rich acquirors (both strategic and PE) and activists may look to take advantage of depressed public equity prices

- PE shops can address any debt financing issues with all equity or over-equitized capital structures and potentially place debt later
- PE has been a source of PIPE financing for companies requiring liquidity

## ▪ After years of dismantling anti-takeover defenses, companies are considering adopting shareholder rights plans to protect against opportunistic takeovers, with an increase in the number of companies choosing to adopt such plans

## ▪ Parties are specifically addressing COVID-19 risks in “Material Adverse Effect” carve-outs

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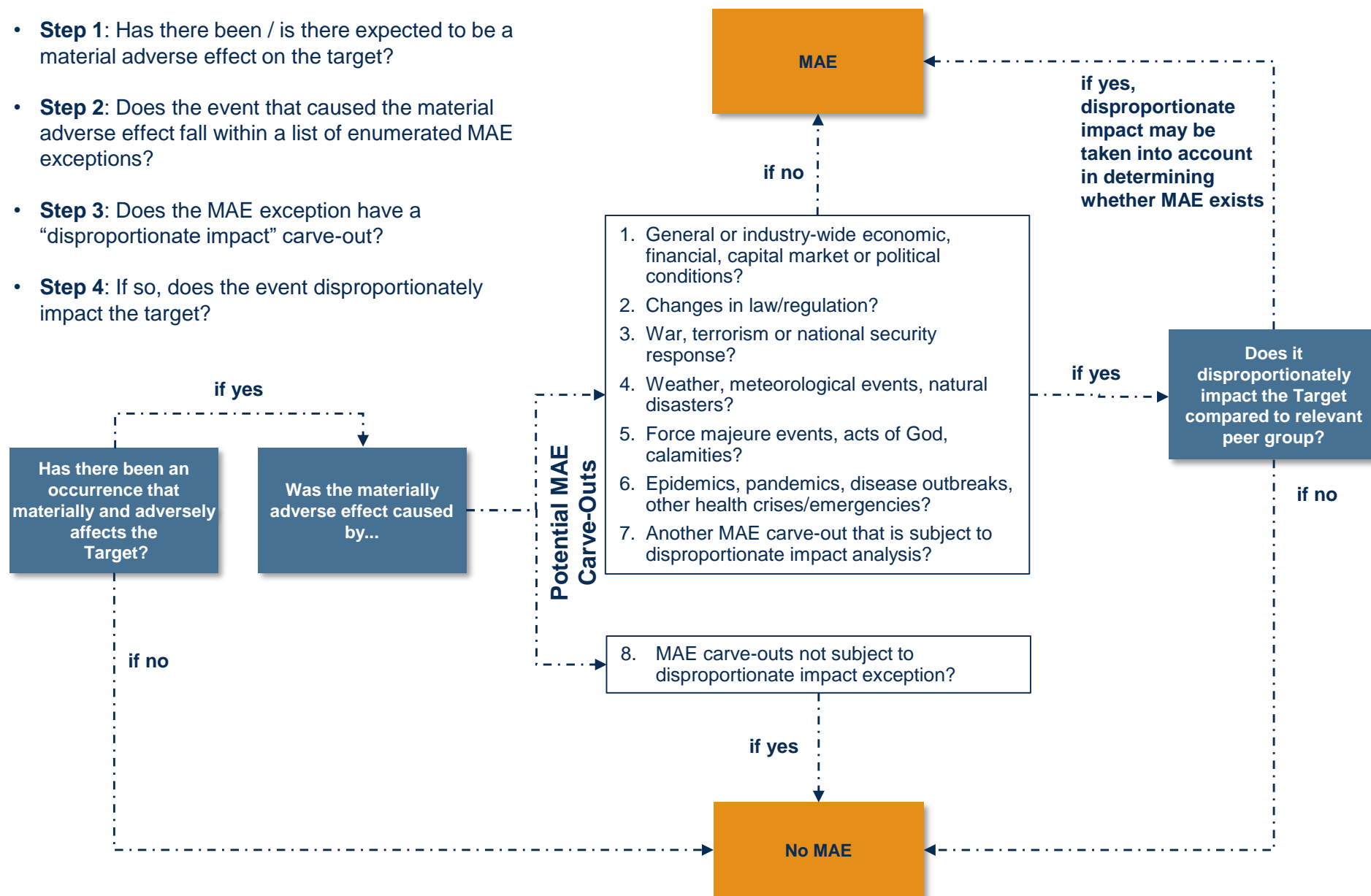
# “Material Adverse Effect”

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# MAE Roadmap

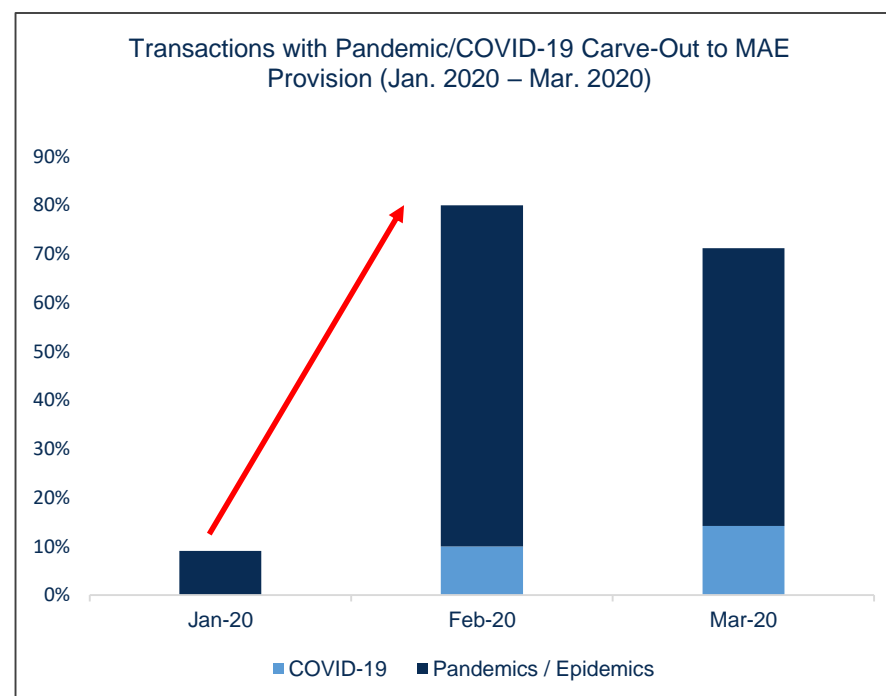
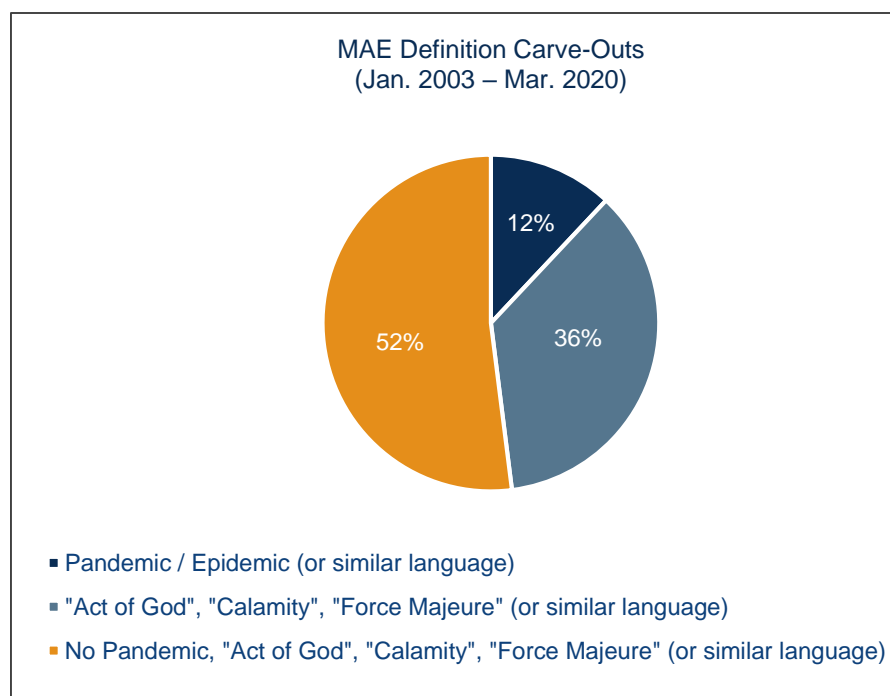
**Note:** Determination of events qualifying for consideration as MAE, carve-outs and disproportionate impact will be subject to fact specific analysis and the actual language in the transaction agreement

- **Step 1:** Has there been / is there expected to be a material adverse effect on the target?
- **Step 2:** Does the event that caused the material adverse effect fall within a list of enumerated MAE exceptions?
- **Step 3:** Does the MAE exception have a “disproportionate impact” carve-out?
- **Step 4:** If so, does the event disproportionately impact the target?



# Potential Carve-Outs: Epidemics, Pandemics, COVID-19

- **Pandemics, epidemics and similar terms were rarely explicitly included as carve-outs to MAE definitions prior to COVID-19**
  - Carve-outs for force majeure events, natural disasters and acts of God were more common
- **Since COVID-19, there has been a sharp increase in explicit carve-outs from MAEs for pandemics, epidemics or similar health emergencies**
  - Since February 1, 2020, 13 out of 17 public target M&A deals over \$100 million included an explicit carve-out for pandemics, epidemics or similar health emergencies
  - COVID-19 was mentioned by name in two MAE carve-outs: Willis Towers Watson-Aon (March 9, 2020) and E\*TRADE Financial-Morgan Stanley (February 20, 2020)



Source: Matthew Jennejohn, Julian Nyarko and Eric Talley, *A "Majeure" Update on COVID-19 and MAEs*, CLS Blue Sky Blog (March 26, 2020) (sample size from FactSet and includes 1,702 Material Adverse Change / Material Adverse Effect provisions from 2003 through March 20, 2020 for deals with transaction values exceeding \$100M where the transaction agreement was publicly available); DealPoint Data (data includes 28 transactions from January 1, 2020 through March 31, 2020 with equity value greater than \$100M where the target was a public company and the transaction agreement was publicly available).

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# Drafting Trends

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## ▪ Explicit carve-out for COVID-19

- *Aon's combination with Willis Towers Watson (announced March 9, 2020):*

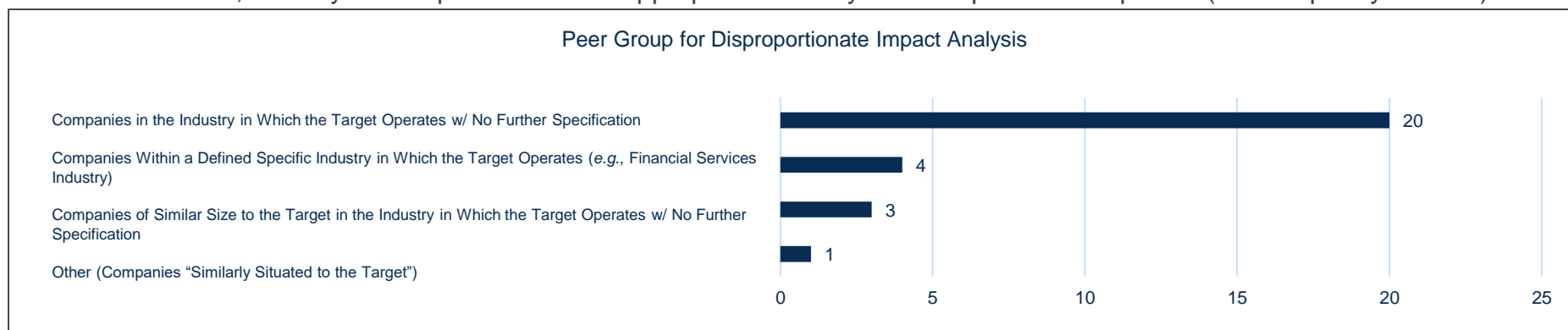
provided, however, that no Effects resulting or arising from the following shall be deemed to constitute a [ ] Material Adverse Effect or shall be taken into account when determining whether a [ ] Material Adverse Effect exists or has occurred or is reasonably likely to exist or occur: (i) Effects arising out of changes in geopolitical conditions, acts of terrorism or sabotage, war (whether or not declared), the commencement, continuation or escalation of a war, acts of armed hostility, weather conditions, **global health conditions (including any epidemic, pandemic, or disease outbreak (including the COVID-19 virus))**, or other force majeure events . . .

- *Morgan Stanley's acquisition of E\*Trade (announced February 20, 2020):*

provided that . . . no event, circumstance, development, change, occurrence or effect to the extent resulting from, arising out of, or relating to any of the following shall be deemed to constitute, or shall be taken into account in determining whether there has been, a Company Material Adverse Effect, or whether a Company Material Adverse Effect would reasonably be expected to occur: (viii) any acts of God, natural disasters, terrorism, armed hostilities, sabotage, war or any escalation or worsening of acts of war, **epidemic, pandemic or disease outbreak (including the COVID-19 virus)** . . .

# “Disproportionate Impact” Exception to the Exception

- **Market practice so far has been that carve-outs for pandemics, epidemics and similar health emergencies do not apply if they have a disproportionate impact on the target relative to (typically) other companies in the target’s industry**
  - Key question will be whether (1) target has been disproportionately impacted and (2) what constitutes the relevant peer group for comparison
- **Drafting of “disproportionate impact” matters**
  - Do you look only at disproportionate impact on target relative to its peer group or does a disproportionate impact eliminate the exception entirely?
- **While there has been an uptick in parties specifically addressing pandemics or COVID-19-related carve-outs in recent MAE definitions, most deals still refer to the target’s industry in a general way to assess “disproportionate impact”**
  - As a result, we may see disputes as to the appropriate industry and comparable companies (if not explicitly defined)



- **Parties should consider whether a more tailored definition of the comparison group is appropriate given the sweeping effects of the COVID-19 pandemic**
  - Whether to specify the applicable industry or geography; whether to limit the comparison group to companies of similar size / other similarly situated companies; etc.

Source: DealPoint Data (data includes 28 transactions from January 1, 2020 through March 31, 2020 with equity value greater than \$100M where the target was a public company and the transaction agreement was publicly available).



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# Pre-Pandemic MAE Definitions in a Post-Pandemic World

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- A pre-pandemic MAE definition that makes no reference to COVID-19 (or even to pandemics or epidemics generally) may or may not be found to include the effects of COVID-19 in determining whether an MAE has occurred
- In such cases, disputes may focus on whether definitional language that typically excludes general economic or market conditions and other broad-based factors impacting the business climate or the target's industry generally is sufficient to exclude the impact of COVID-19
- Parties may further dispute the appropriate industry and comparable companies for disproportionate impact analysis, and may also debate the extent to which a party was disproportionately impacted relative to its peer group
- Parties also may debate whether the impact is sufficiently long-lasting to be considered an MAE under applicable state law, noting that for different industries the impacts of COVID-19 and the resulting fall-out will not be uniform
- Ultimately, however, MAE determinations will hinge on the specific facts and circumstances and depend on the nature and extent to which an event or series of events affect the particular target's business

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# Pre-Closing Covenants and Representations and Warranties

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# Interim Operating Covenants

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- **Parties should consider the potential impact of COVID-19 on the target's ability to comply with its interim operating covenants**
  - Interim operating covenants (IOCs) require the target to continue its operations in the ordinary course of business / consistent with past practices and to refrain from taking certain actions without the buyer's consent
  - Buyer is typically not permitted to unreasonably withhold, delay or condition its consent to actions outside affirmative and negative IOCs
    - Reasonableness of withheld consent may be the subject of disputes, such as Delphi Technology's allegation that BorgWarner unreasonably withheld consent to Delphi's request to draw on its credit facilities
  
- **In both pending signed deals, as well as deals currently under negotiation, the parties should evaluate the following:**
  - What does it mean to operate in the ordinary course of business / consistent with past practice in the current COVID-19 environment?
    - Does the target company have an unqualified obligation to do so? Or is the target company only required to exert a specified level of effort to do so (such as "commercially reasonable efforts")?
      - What do best efforts / reasonable best efforts / commercially reasonable efforts / reasonable efforts mean under the current circumstances?
  - In addition to a general undertaking to operate in the ordinary course of business / consistent with past practice, does the target have specific affirmative obligations to maintain its existing business organization, keep services of employees, preserve relationships with key suppliers, customers and other business partners, etc.?
  - Is the target prevented from taking certain "rescue" measures without the buyer's consent (e.g., drawing down on existing revolving lines of credit, reducing workforce, shutting down facilities)?
  - Is the target excused from complying with its interim operating covenants?
    - Exceptions for actions required by applicable law (and what does that encompass)?
    - Exceptions under legal doctrines of impossibility / impracticability?

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# Provisions to Consider Including in IOCs

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- **Sellers seeking to ensure adequate flexibility to operate during the COVID-19 pandemic should consider including exceptions to address the coronavirus, either directly in the transaction agreement or as disclosures in the disclosure letter**
  - Consider including an exception for actions required to comply with or respond to any quarantine, “shelter in place”, “stay at home”, workforce reduction, social distancing, shut down, closure, sequester or any other law, order, directive, guidelines or recommendations by any governmental entity in connection with or in response to COVID-19 (“COVID-19 Measures”)
  - Further consider an exception for actions taken or not taken in good faith to respond to the actual or anticipated effect of COVID-19 or any COVID-19 Measures
    - Can be limited to apply to actions “generally consistent with actions taken or not taken by similarly situated businesses” or actions “generally consistent with any COVID-19 action plan” discussed in advance with purchaser
- **Parties should also consider expanding pre-closing cooperation or information access covenants to cooperate in the development and implementation of an action plan to address possible impacts of COVID-19 and the COVID-19 Measures**
- **Buyers, of course, may push back on such flexibility and seek to ensure their consent is required for actions outside the ordinary course and inconsistent with past practice or that they must be consulted with so they can provide input as things develop**

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# Representations and Warranties

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- **Parties should consider the ability of the target to “bring down” its representations and warranties at closing, and the extent to which they must be true and correct at closing**
- **Parties should be mindful of the following specific areas of concern:**
  - Shut-downs and business closures (either mandated by the government or as a result of changes in consumer behavior)
  - Supply chain disruptions
  - Insufficient inventory
  - Collectability of ARs / payment of APs
  - Loss of customers (including as a result of customers going out of business)
  - Layoffs or other loss of employees
  - Inability to perform material contracts / inability of counterparties to fulfil their obligations under material contracts
  - Liquidity and availability of capital
  - Ability to maintain leverage ratios and other financial covenants under debt instruments
  - Ability to maintain solvency
  - Effects of “working from home” (e.g., data protection and data security breaches, HIPPA compliance)
  - Impairment charges and write-down of assets

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# Regulatory Delays and End Dates

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- **Parties should anticipate delays in securing regulatory approvals and third-party consents between signing and closing, including:**
  - Delays related to antitrust and other regulatory approvals
  - Consents to anti-assignment / change-of-control provisions
  - Shareholder meetings / approvals
- **Antitrust delays are already impacting deal closings**
  - HSR early termination once again available (effective March 30), but on a more limited basis for the duration of the pandemic; to be granted more slowly and in fewer cases
- **Recent M&A agreements have not included constructs to extend the end date due to the impact of COVID-19 (outside of customary extension language for HSR or other regulatory approvals)**
  - But we would expect to see extension mechanics similar to those seen in the context of the government shutdown in 2019
- **Parties should consider appropriate mechanisms in transaction agreements to allocate risks of delays in closing**
  - Parties should consider a more distant end date or extension / tolling language for delays related to or caused by COVID-19
  - Parties should incorporate similar concepts into financing documentation to avoid obligation to close without available financing
- **Cravath has published materials entitled “COVID-19 Antitrust Insights: Merger Review Updates” with more information on the impact of the COVID-19 situation on the merger review process**

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# Rep and Warranty Insurance

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# Rep and Warranty Insurance in a COVID-19 World

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- **Market for R&W insurance is still open, with insurers still willing to underwrite policies for pending transactions**
  - Pricing so far has been unaffected, but companies should expect COVID-19 exclusions (in one form or another)
  - Heightened risk commentary in non-binding letters of indication, with insurers focused on understanding COVID-19 impacts, such as the impact on a target company's supply chain and business operations
  - Enhanced levels of due diligence relating to COVID-19, with MAE provisions, representations related to "absence of changes" and IOCs undergoing heightened scrutiny
  - Increased scrutiny expected for deals with longer interim periods
  - Less "brand name" underwriters are more willing to be aggressive in underwriting approach
- **R&W insurers are willing to insure breaches of reps and warranties but do not want to underwrite business risk; insurers are implementing solutions to isolate business risk from rep and warranty breaches**
  - In this context, insurers are focusing on COVID-19 risk and how it impacts not only the drafting of reps and warranties (and thus what they have to underwrite), but how it impacts the likelihood of breaches (and thus the likelihood of claims)
  - Insurers are also focused on reps and warranties that are being added to address COVID-19-related risks, and may seek to exclude such COVID-19 related reps and warranties from coverage



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# Rep and Warranty Insurance in a COVID-19 World

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- **Insurers are assessing how to address COVID-19 exclusions in their policies**
  - Blanket COVID-19 exclusion
  - Blanket COVID-19 exclusion for high risk industries, such as transportation, retail, entertainment, hospitality, education, personal care, healthcare / medical and industries / companies with global supply chain risk
  - Deal specific exclusions looking at the specific company and industry and assessing the appropriateness of an exclusion on a case-by-case basis
  - Focus on reps that are more likely to be affected, such as material contracts, employee matters, data security, and reps relating to supply chain
- **In addition to formal exclusions (where the burden of proof is on the carrier to establish that an exclusion applies), some insurers are trying to carve-out COVID-19 from the definition of covered “Losses” (shifting the burden of proof on the insured to show what portion of the loss is not attributable to COVID-19)**
- **Some insurers are redefining the concept of “interim breach” (which is not covered by rep and warranty policies) to include any COVID-19 related breaches that arise after signing, thereby effectively only underwriting rep and warranty breaches due to COVID-19 in existence at signing (an area where insurers are very actively performing diligence)**
- **To date, we are not aware of any COVID-19-related claims on closed deals, but the pandemic and the market are evolving day by day**

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# Diligence

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# Conducting Due Diligence

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- **Parties should expect increased due diligence timelines**

- Challenges in creating/populating data room while employees don't have access to office files
- Inability to conduct in person due diligence sessions, site visits, employee meetings, etc.
- Deep dive due diligence around IT contingencies and ability of target to stand up and operate its business "remotely"
- Analysis of enforceability of / remedies under material contracts
- Heightened due diligence by financing sources and rep and warranty insurance underwriters
- Analyzing working capital, sufficiency of inventory, collectability of AR, payment of APs, etc.

- **Buyers should analyze (i) key contracts required to operate the target's business to determine if they are enforceable and (ii) situations where buyers may walk into a breach if the target's contracts cannot be performed post-closing**

- Force Majeure: Buyers should carefully review (i) whether there are force majeure clauses in the target's commercial contracts and (ii) if so, the precise language of such clauses (e.g., enumerated list of events reasonably including COVID-19 or general catch-all provision)
- Termination Rights: Buyers should review contracts' termination provisions and evaluate whether there are extra-contractual "outs" available to the parties, e.g., on account of performance becoming illegal, impossible, unreasonable or otherwise constrained
- Efforts Standard: Parties should ascertain whether key contracts contain flat obligations on the part of target and its counterparties or efforts obligations or obligations to perform to "industry standards" that may arguably not require performance
- Restrictions on Performance: Contracts may require performance at, or delivery to or from, specific locations that may not be practical given the impact of COVID-19 or illegal in light of recent laws and regulations
- Insurance Coverage: Buyer should assess whether the target's insurance policies provide coverage for anticipated losses associated with business interruption on account of COVID-19

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# COVID-19-Related Due Diligence Questions

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- **Buyers, financing sources and R&W insurers are digging into the effect of COVID-19 on target company business operations**
  - Due diligence questions are focused on the impact on business operations and continuity, counterparty risk and valuation
- **Business operations and continuity due diligence questions focus on:**
  - What changes target companies have made to normal business operations due to COVID-19
  - Whether precautions or business continuity plans have been implemented by target companies in response to COVID-19
  - What steps have been taken regarding business continuity
  - Whether target companies have closed locations and the effect on the target if a significant number of employees are quarantined or required to work remotely
  - Whether target companies are still operating out of their normal facilities, whether their employees are required to work from home, and how IT systems have responded to any increases in employees working remotely
  - Whether target companies have been subject to complaints or claims alleging the company failed to provide a safe working environment or accommodation in relation to COVID-19
  - What disruptions target companies have experienced in their supply chain and distribution networks, including specific details regarding the ability of target companies to receive inventory and ship to customers in a timely manner
  - Whether target companies have been able to utilize shipping companies, such as FedEx, UPS or other vendors, to ship products
  - What additional actions the target company plans to take in response to COVID-19

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# COVID-19-Related Due Diligence Questions

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- **Counterparty risk due diligence questions focus on:**

- Whether target companies have discussed and received confirmation regarding the ability of outside vendors to maintain business continuity
- Whether any counterparties have been unable to perform under existing contracts
- Whether there have been any disputes with material vendors or whether any material vendors have provided notice of a need to modify the existing relationship
- Whether target companies have issued or received notices seeking to excuse non-performance under existing contracts due to interruptions caused by COVID-19
- Whether target companies are aware of any claims made or intended to be made by the company's insurance providers due to the cancellation of events or business interruptions caused by COVID-19

- **Due diligence questions related to valuation focus on:**

- Whether COVID-19 has impacted the party's views on the value of the target company's business and whether any concessions have been sought by counterparties
- Whether target companies have adjusted their earnings projections as a result of COVID-19 and the impact on near-term (next few months) and long-term projections for the business
- Whether target companies have or expect to delay or change any strategic plans, such as acquisitions, dispositions, restructurings, business expansions, capital expenditures or implementation / testing as a result of COVID-19
- How COVID-19 has affected working capital / liquidity and if timing of AR / AP will become mismatched

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# Other Topics

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# Valuation Considerations

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- **COVID-19 also poses serious valuation challenges for boards and their financial advisors**
- **How does a board think about valuation and how do financial advisors make assessments regarding what is “fair” in the current environment?**
- **How does a public company think of intrinsic value relative to significantly depressed / sudden stock price declines for both itself and its comparables?**
- **How do boards and financial advisors think about management projections?**
  - Is management revising previously adopted projections / forecasts? If so, can management develop credible projections given the unprecedented situation and uncertainty regarding how long it will last?
  - Should boards develop different cases depending upon how long the larger economic impact may last? Sensitivities?
- **Beyond just projections, how do boards assess and quantify the potential impact of anticipated delays between signing and closing, and how do parties assess the potential pricing impact on transactions?**
- **How do boards and financial advisors deal with volatility?**
  - Financial advisors are beginning to reinsert volatility exceptions in fairness opinions, similar to the approach taken in past crises
- **How do financial advisors identify reliable and applicable trading comps and precedent transactions?**
  - How should comparable companies analysis be conducted and evaluated given unprecedented levels of market volatility, and through what lens should it be viewed?
  - How should precedent transactions be identified and analyzed given unprecedented market atmosphere?

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# Going to Court

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- **COVID-19 may impair, but will not preclude efforts to pursue lawsuits and seek equitable remedies in a timely fashion**
- **Delaware court facilities closed to the public until at least May 14**
  - Courthouse staffing reduced to focus only on emergency / essential matters, particularly related to criminal justice
  - Employees not part of limited staffing to work remotely as directed
- **Delaware Court of Chancery hearings are being conducted telephonically or by video conference (using Zoom and similar services)**
  - Hearings and trials that cannot be conducted remotely are being postponed
  - In person hearings are available only upon a showing of “exigent need”—*e.g.*, “the existence of a threat of imminent irreparable harm”
- **Delaware Supreme Court has suspended oral arguments until May**
- **New York State Supreme Courts (trial courts and appellate divisions) are performing only “essential functions,” defined as “court functions that cannot be postponed without serious consequences to the parties involved”**
  - Only accepting filings related to enumerated list of essential matters, such as mental hygiene applications, civil commitments and guardianships; all others determined on a case-by-case basis
  - Hearings are being automatically adjourned
  - Non-ongoing civil trials have been suspended until further notice
- **SDNY has postponed all civil and criminal jury trials scheduled to begin before April 27 and made compliance with all other trial-specific deadlines subject to discretion of the presiding judge**
  - Individual judges are authorized to hold hearings or bench trials in the exercise of their discretion, but are encouraged to conduct proceedings by telephone or video conference where practicable



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# Going to Court

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- **Across all courts, applications for injunctive relief likely to be handled telephonically or by video conference, with a preference for maximizing adjournments and stipulations on consent**
  - Courts expected to urge the parties to agree to stays or standstill to freeze the status quo and avoid irreparable harm or a change in circumstances that would be prejudicial to either side
  - Where expedited discovery is warranted, discovery likely would be limited to documents that can be searched for and produced electronically
- **Despite early resistance by parties to “virtual” depositions, expect gradual adoption as courts press to demonstrate that they are open for business**
  - Courts may direct the parties to proceed with depositions on a virtual basis
- **Courts beginning to experiment with virtual trials in non-jury cases**
- **Policies adopted by courts will be impacted by length of time COVID-19 is anticipated to last (e.g., 60-90 days or to extend indefinitely)**

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# Shareholder Activism

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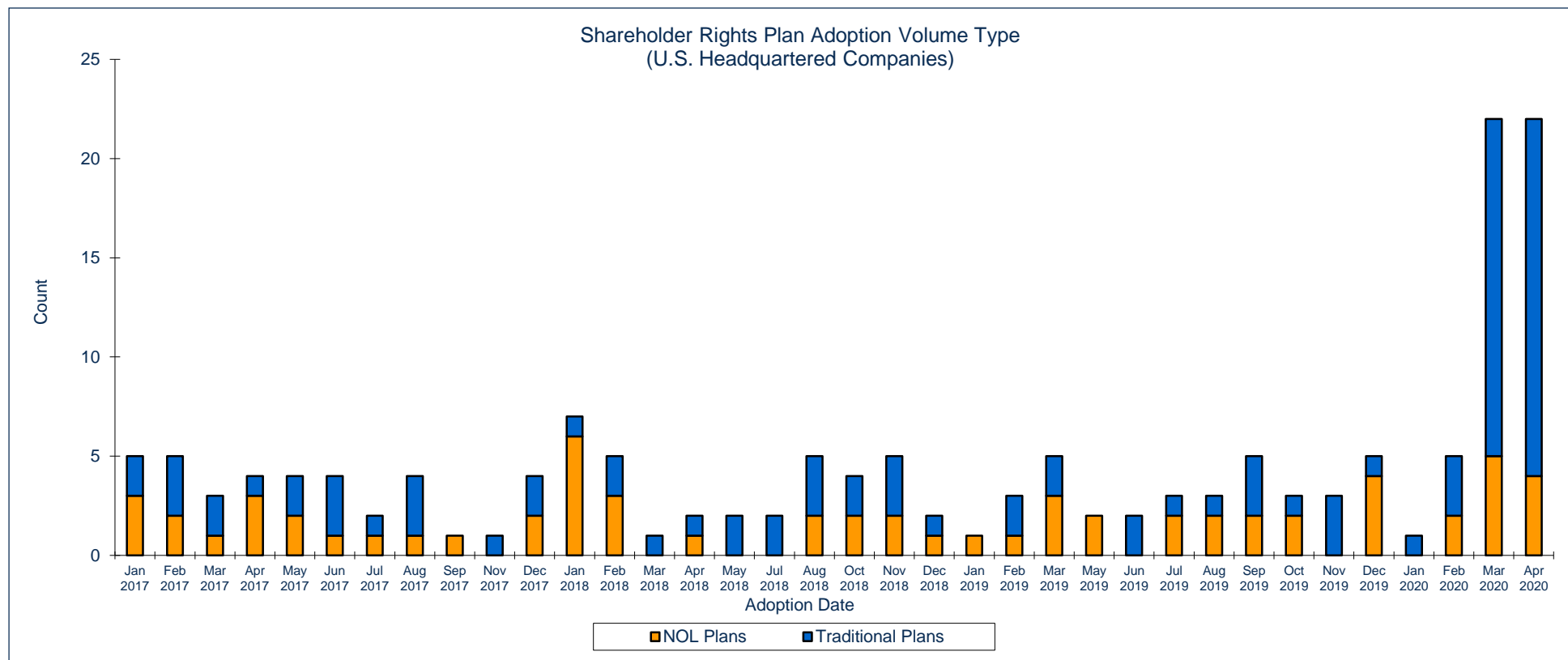
# What Are We Seeing and Hearing?

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- **Declines in public company stock prices are making companies feel more vulnerable to shareholder activism and hostile attacks**
- **Increase in questions from public companies about shareholder rights plans and updates to “on the shelf” plans, with an increase in the number of companies choosing to adopt shareholder rights plans (both traditional defense plans and NOL plans)**
- **Reduced levels of campaign activity in March after robust levels of shareholder activism in the first two months of the year**
- **Mixed impact on activist performance creates uncertainty for activist environment in the near term**
  - Pressure on shareholder activists facing losses in their current holdings (particularly if limited partners seek redemptions), as well as a challenging environment for common activist campaigns (e.g., M&A and capital return themes) could constrain shareholder activism in the immediate or near term
  - But with certain activists outperforming, as well as others seeking to raise capital, reduced valuations could create favorable circumstances for some activists in certain situations to initiate new (or double-down on existing) campaigns
- **In light of this uncertainty, preparedness will continue to be key**
  - Depressed stock prices allow for easier activist entry point
  - However, the current unprecedented situation does not lend itself to easy activist thesis to fix things, and activists run the risk of alienating other shareholders if they are perceived as acting opportunistically in the midst of the pandemic
  - Activists may use depressed prices to take position now and wait for some stability to press for change / M&A catalysts based on how the market looks at a later date
- **Importance of continued engagement with shareholders throughout the COVID-19 pandemic, particularly related to corporate response to COVID-19**

# Increase in Adoption of Shareholder Rights Plans

- **Significant drops in share prices led a number of companies to implement shareholder rights plans in March and April**
  - 44 U.S. headquartered companies adopted new shareholder rights plans
  - Of the 44 companies adopting new plans, 35 adopted shareholder rights plans as a traditional anti-takeover defense
  - Nine adopted plans primarily to preserve net operating loss carryforwards, which is not viewed as a traditional anti-takeover defense; additionally, one traditional plan also adopted with the dual purpose to preserve net operating loss carryforwards<sup>1</sup>
  - 27 of the 35 companies adopting shareholder rights plans as a traditional anti-takeover defense cited the impact of COVID-19 when announcing the adoption



Source: DealPoint Data (through April 24, 2020); press releases.

(1) The shareholder rights plan that was adopted as a traditional anti-takeover defense and also to preserve net operating loss carryforwards was categorized only as a traditional plan for purposes of this analysis.

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# Notable Features of Recent Traditional Rights Plans

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- **Increased prevalence of lower triggers (10% or less)**

- 23 out of 35 (66%) of traditional rights plans adopted in March-April have a trigger of 10% or less, with three companies adopting plans with triggers of 5%
- Less than 22% of all U.S. companies with active traditional plans as of January 1, 2020 had a 10% or less trigger

- **Two-tier triggers, which exempt or set a higher trigger threshold for passive investors, have also been more common**

- 22 out of the 35 traditional plans adopted in March-April exempted or featured higher triggers for passive investors
  - 18 plans set higher trigger (generally 15-20% relative to 10-15%) for passive investors
  - Four plans exempt passive investors entirely from definition of “Acquiring Person”
  - 13 remaining plans do not distinguish passive investors from other investors in definition of “Acquiring Person”

- **Plans capturing derivatives and investors acting in concert**

- All 35 traditional shareholder rights plans adopted in March-April include derivatives in the definition of “Beneficial Ownership”, relative to about half of U.S. companies with active traditional plans as of January 1, 2020
- All 35 traditional plans capture investors acting together through formal or informal arrangements for purposes of determining “Beneficial Ownership”

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# Notable Features of Recent Traditional Rights Plans

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- **33 out of the 35 traditional plans are of limited duration (terms of one year or less)**
- **However, one company adopting a traditional plan with a three-year term is required to obtain stockholder approval to ensure the plan does not expire after one year**
- **Only two of the companies adopting traditional plans committed to put rights plans to a shareholder vote at their 2020 annual meeting**
- **Higher exercise price to market price ratios due to depressed stock prices**

# Proxy Advisor Guidance on Traditional Rights Plans

## ▪ Institutional Shareholder Services (ISS)

- For rights plans with a duration of less than one year, ISS takes a case-by-case approach based on the disclosed rationale for adoption and other relevant factors (e.g., commitment to put any future plan renewal to a shareholder vote)
  - ISS will continue to take this approach, which includes, “examining whether directors appear to have sought to appropriately protect shareholders from abusive bidders without inappropriately entrenching the existing board and management team”
  - In this context, ISS will generally consider the board’s explanation for adoption, which will include an examination of “imminent threats” and the plan’s specific provisions
- ISS generally encourages boards to put shareholder rights plans to a shareholder vote, but also gives companies “latitude in adopting short-term rights plans with reasonable triggers in response to active threats”
  - ISS notes that “[a] severe stock price decline as a result of the COVID-19 pandemic is likely to be considered valid justification in most cases for adopting a pill of less than one year in duration”
  - ISS also notes that boards should disclose in detail their choice of duration / decisions to delay or avoid putting plans to a vote beyond that period, and also notes that triggers will continue to be closely assessed in the context of the plan’s rationale and length (among other factors)

## ▪ Glass Lewis

- Generally opposed to shareholder rights plans, but supportive of plans that meet certain conditions, particularly “if limited in scope to accomplish a particular objective”
- Glass Lewis considers companies impacted by COVID-19 and the related economic crisis as reasonable context for adopting a rights plan if:
  - The duration of the rights plan is limited to one year or less; and
  - The company discloses a sound rationale for adoption of the plan as a result of COVID-19
- If the plan does not meet these conditions Glass Lewis will recommend opposing the re-election of all directors who served on the company’s board at the time of the plan’s adoption
- Glass Lewis also notes that companies can provide shareholders with additional confidence by assuring them at the time of the plan’s adoption that any renewal will require shareholder approval

Source: Institutional Shareholder Services, *Impact of the COVID-19 Pandemic*, ISS Policy Guidance (April 8, 2020); Glass Lewis, *Poison Pills and Coronavirus: Understanding Glass Lewis’ Contextual Policy Approach* (April 8, 2020).

# Proxy Advisor Guidance on Traditional Rights Plans

- Different proxy advisors may have different recommendations when a shareholder rights plan is adopted, as seen in the case of The Williams Companies' recent plan with a 5% trigger
- Glass Lewis determined The Williams Companies' rights plan was appropriate under the circumstances

*"We are encouraged by the rights plan's limited duration, as well as by the Company's disclosure regarding the need for such a plan at this time and its communication with shareholders. We believe it would be in shareholders' best interests for the board to seek shareholder approval prior to extending or renewing the rights plan in the future. However, we do not believe action against any directors is warranted at this time. We will monitor this issue going forward."*

**Glass Lewis, April 2020**

- In contrast, ISS recommended against supporting the election of the chairman of The Williams Companies, and recommended cautionary votes for all other directors

*"Though the length of the 12-month pill, in isolation, is not problematic in the current economic environment, the term must be examined in combination with the 5 percent hair-trigger selected by the board. . . . When ISS asked the company whether it had considered a shorter term, the answer appeared to be 'no.' When ISS asked the company whether it had considered adopting a more standard pill with a higher trigger and using its upcoming annual meeting to seek shareholder ratification of its 5 percent plan, the answer appeared to be 'no.' . . . While the company intends to submit the pill for shareholder approval if extended, the adoption of a 5 percent trigger is problematic, as it is highly restrictive and could negatively impact the market for the company's shares as the market recovers. As such, support is not warranted for Chairman Stephen Bergstrom, who presides over meetings of the board, and cautionary support is warranted for all other directors at this time."*

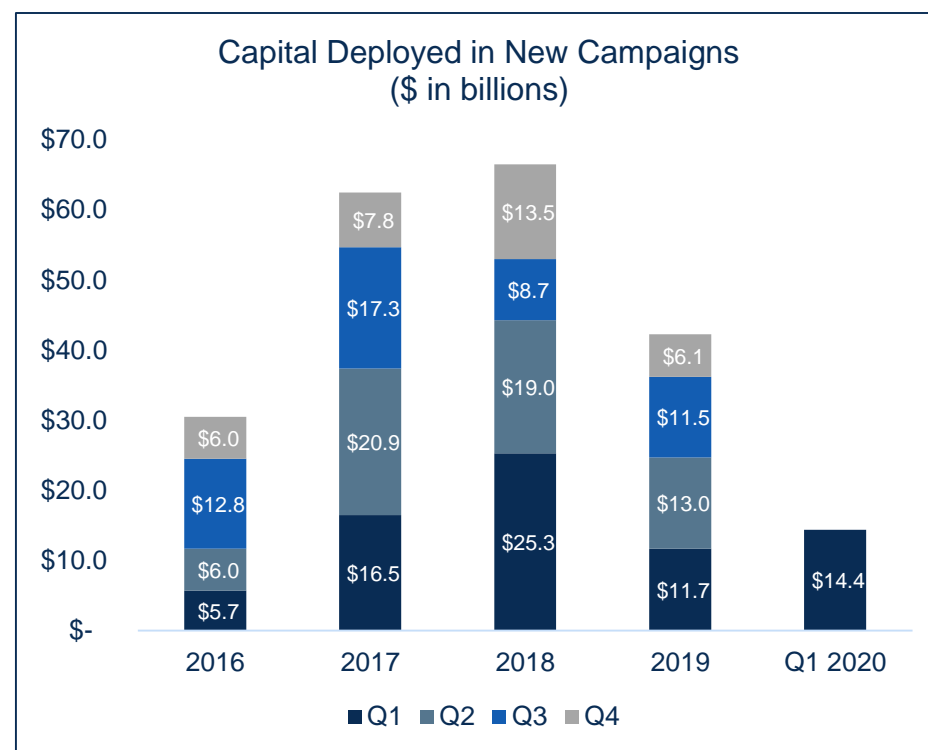
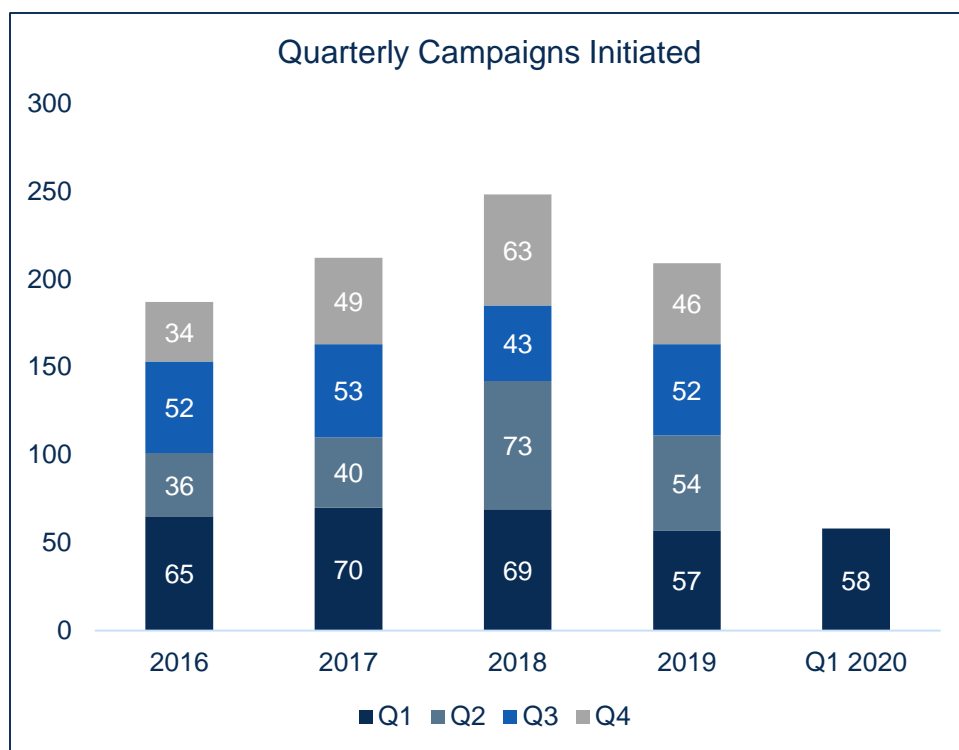
**ISS, April 2020**



# Trends in Shareholder Activism

## ▪ Robust Q1 2020 for shareholder activism driven by strong January and February

- 58 campaigns initiated against 58 companies globally in Q1 2020, an increase relative to Q1 2019, which featured 57 campaigns against 53 companies; the 58 campaigns in Q1 2020 were slightly above the quarterly average of 53.5 campaigns from 2016-2019, but somewhat below the Q1 average for new campaigns (65.25) over that same timeframe
- Increase in capital deployed in Q1 2020 (\$14.4B) relative to Q1 2019 (\$11.7B); Q1 2020 capital deployed was above the quarterly average from 2016-2019 (\$12.6B), although slightly below the Q1 average (\$14.8B) over that same timeframe



## ▪ There was a significant drop-off in the level of shareholder activism in March 2020 (see next slide)

Source: Lazard, *Review of Shareholder Activism – Q1 2020* (data for global campaigns at companies with market capitalizations greater than \$500 million at the time of campaign announcement; companies spun off as a part of the campaign process counted separately).

# Trends in Shareholder Activism

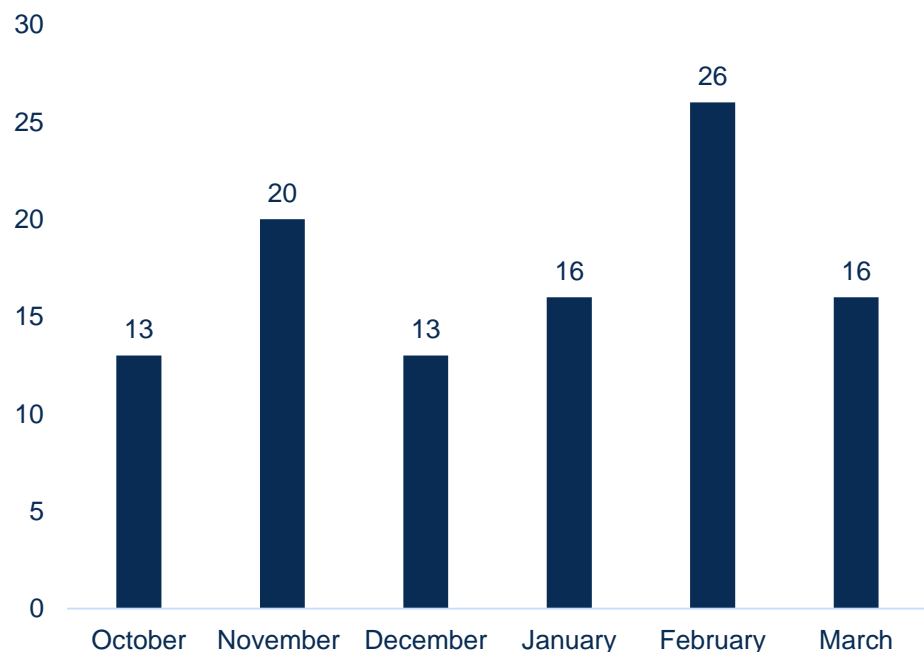
## ▪ 16 new campaigns initiated in March 2020

- A decrease from the 26 new campaigns initiated in February, but in line with the average number of campaigns initiated from October 2019-February 2020 (17.6)

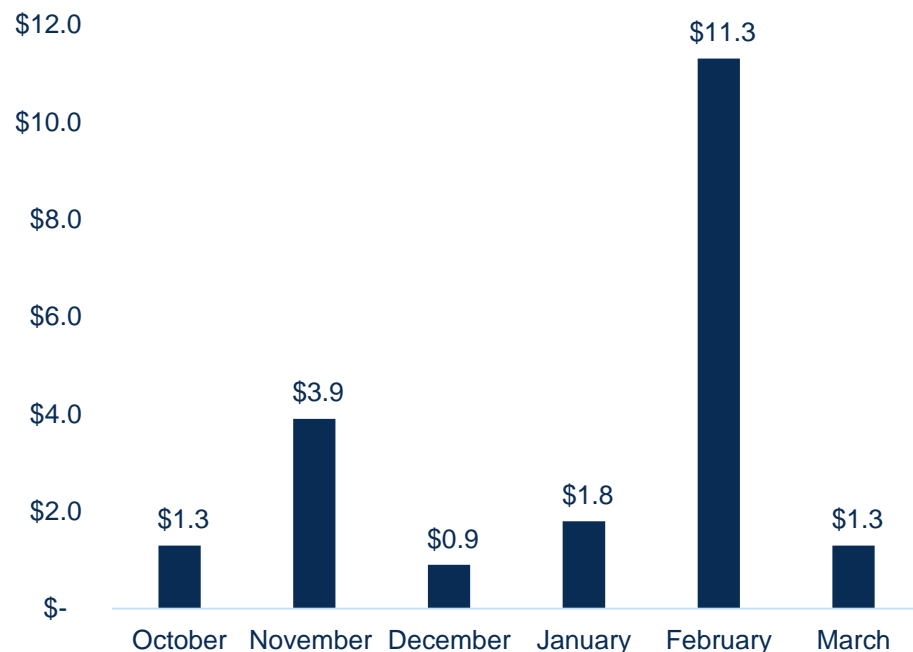
## ▪ \$1.3B deployed in new campaigns in March 2020

- Down significantly from the \$11.3B deployed in February (although \$7.4B came from three campaigns), and down substantially relative to average capital deployed in new campaigns from October 2019-February 2020 (\$3.8B)

Campaign Initiations  
(October 2019-March 2020)



Capital Deployed in Last Six Months  
(\$ in billions)



Source: Lazard, *Review of Shareholder Activism – Q1 2020* (data for global campaigns at companies with market capitalizations greater than \$500 million at the time of campaign announcement; companies spun off as a part of the campaign process counted separately).

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# Activists Are Also Facing Pressure

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- **Activists are grappling with the recent market volatility, which has led a number of high profile activists to abandon ongoing campaigns**
  - Elliott Management dropped opposition of CapGemini's ~\$4 billion acquisition of Altran Technologies after arguing for months the deal undervalued Altran, citing "current market conditions"<sup>1</sup>
  - Robert Tchenguiz, a U.K.-based activist investor, announced he "regrettably" sold his stake in FirstGroup Plc after months of challenging the company's directors and management, citing "the unprecedented circumstances and the consequential challenges the world is now facing"<sup>1</sup>
- **Notably, M&A-related campaigns have been a dominant theme amongst activist campaigns in recent years, and with headwinds facing the global M&A market in the near-term, this could further dampen activist activity levels**
- **Returning capital to shareholders (another common activist objective) is also difficult in the current environment, which could further limit campaign activity**
- **Campaign activity could also be constrained so that activists are not perceived as taking advantage of the pandemic, which could hurt their credibility with target companies and alienate them from other shareholders**
- **However, despite the uncertainty, companies should continue to focus on ensuring adequate preparation for activist engagement, and should continue to be proactive about engaging with shareholders regarding corporate response to the pandemic**

(1) Ben Scent, *Activist Investors Throw in Towel as Market Turmoil Rages*, Bloomberg (March 20, 2020).

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