Defensive Measures

May 16, 2017

Katharine Martin
Corporate

Amy Simmerman
Corporate

The materials in this presentation, and the opinions expressed in this webinar, are those of the authors and speakers, respectively, and do not necessarily reflect the opinions of the companies or institutions with which such authors or speakers are affiliated. In addition, neither these materials nor the views expressed in this webinar are intended to constitute legal advice as to any particular situation.
Roadmap

• What we do mean by defensive measures?
• What are your options at the IPO stage, and what will your likely approach be at the IPO?
• What market pressures will a company come under as it moves away from its IPO?
• Is a dual-class or multi-class approach a good alternative?
• Our perspectives are based on our expertise in:
  – Representing many late-stage private companies and public companies
  – Delaware corporate law
Defensive Measures in General

• What do we mean by “defensive measures”?
  – Provisions in a company’s governing documents—its charter and bylaws—that help protect the company in certain key ways:
    ▶ 1. Guard against an undesirable, hostile takeover
        – Ensure that the board, as central decision-maker, cannot be easily replaced
        – Prevent an easy acquisition of a large stake in the company
    ▶ 2. Give the company time to respond in an orderly manner if the company comes under pressure by stockholders, including activists
        – Such pressure could also include stockholder proposals or nominations of only one or two directors
Prototypical Defensive Measures

- **Board composition and powers**
  - Classified board, paired with directors being removable only for cause
  - Supermajority vote for director removal
  - Only board sets board size and fills empty seats
  - Board authorized to adopt, amend, and repeal bylaws

- **Related to stockholders**
  - No stockholder action by written consent between annual meetings
  - Stockholders cannot call special meetings
  - Advance notice bylaw provision for meetings
  - Supermajority vote to amend certain charter and bylaw provisions
  - Supermajority vote for mergers
  - No cumulative voting
  - Exclusive forum provision

- **Related to an acquiror**
  - Blank check preferred stock
  - Actual adoption of pill or poison pill on shelf
  - Keep company subject to Section 203 of Delaware General Corporation Law/state anti-takeover statute
Likely Approach at IPO Stage

• Delaware law, which your company is likely incorporated under, is extremely flexible and enabling on these issues

• A company will generally want to go out strong, with many defensive measures:
  – Protective of company
  – Much harder to adopt later – either mechanically (for example, may require a charter amendment, with stockholder approval) or because of likely reactions from stockholders and ISS and Glass Lewis
  – Adopt measures on a clear day
Market Pressures

• But, many companies come under pressure to – and do – dismantle some of these protections not long after the IPO

• Public company life was not always this way

• Sources of such pressure:
  – Institutional investors
  – ISS/Glass Lewis
  – Stockholder proposals

• For example:
  – At IPO, 74% of companies have a classified board; of the S&P 500, 10% do
  – At IPO, 72% of companies prohibit stockholders from calling special meetings; of the S&P 500, 37% do
  – Companies much less likely to have a poison pill in place
An alternative? Dual-Class or Multi-Class Structures

• General concept: Provide certain stockholders with a greater proportion of voting power to insulate the company from short-term pressures or stockholder activism

• Illustrative approaches:
  – Dual-class structure: Pre-IPO stockholders get high-vote stock and new public stockholders get low-vote stock (LinkedIn)
  – Snap approach: Sell non-voting stock to public
  – Multi-class approach: Three tiers of voting power (e.g., to founders, other original stockholders, new public stockholders) or dual-class structure paired with a class of non-voting stock (Google and Facebook)

• Provides flexibility to company; we have done many of these

• But not right for all companies, and we will need to keep an eye to ongoing reactions from the SEC, judges, and the investor community – especially regarding sunset provisions
Takeaways

• Defensive issues are all about protecting the company and the ability of the board to steer the company as appropriate for stockholders
• Companies have significant flexibility for structuring their defensive measures under Delaware law
• When going public, companies will likely want to have many of these protections
• But there will be market pressure to dismantle and weaken defenses
• Dual-or multi-class structures may be an interesting alternative, depending on the company – but keep an eye to market, regulatory, and judicial reactions
Thank you!

Katharine Martin
Wilson Sonsini Goodrich & Rosati
650 Page Mill Road
Palo Alto, CA 94304
kmartin@wsgr.com
Office: (650) 565-3522

Amy Simmerman
Wilson Sonsini Goodrich & Rosati
222 Delaware Avenue, Suite 800
Wilmington, DE 19801
asimmerman@wsgr.com
Office: (302) 304-7607