

ments to Form D that the Commission proposed in 2013 to enhance the Commission's ability to evaluate Rule 506 market practices. *See* Amendments to Regulation D, Form D, and Rule 156, Release No. 33-9416 (July 10, 2013). It should also involve renewed consideration of updating the accredited investor definition wealth thresholds, including by indexing the wealth thresholds to inflation going forward, an idea with broad-based support. *See* Allison Herren Lee and Caroline Crenshaw, Joint Statement on the Failure to Modernize the Accredited Investor Definition (Aug. 26, 2020).

SEC/SRO UPDATE: DELAWARE CHANCERY COURT STRIKES DOWN THE WILLIAMS COMPANIES' COVID-19 POISON PILL; SEC DIVISION OF EXAMINATIONS ANNOUNCES 2021 EXAMINATION PRIORITIES

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Delaware Chancery Court Strikes Down the Williams Companies' COVID-19 Poison Pill

On February 26, 2021, the Delaware Court of Chancery declared a “poison pill” rights plan unenforceable and issued a mandatory injunction against its continued operation.¹ The Williams Companies’ (“Williams”) board of directors adopted the “anti-activist” pill in light of the COVID-19 pandemic and amid a global oil price

war.² Stockholders challenged the pill’s combination of features, which the court classified as “more extreme” than any other it had previously evaluated.³ Specifically, the pill included a 5% trigger threshold, an expansive definition of “acting in concert,” and a narrow definition of “passive investor.”⁴

The court employed the traditional two-part *Unocal* intermediate standard of review to analyze the stockholder’s challenge: (1) whether the board had reasonable grounds for concluding that a legitimate threat to the corporate enterprise existed, and (2) were the board adopted measures reasonable in relation to the threat posed.⁵

Williams claimed the following three legitimate threats to its corporate enterprise:

1. Stockholder activism during a period of market uncertainty and in which its stock price was low;
2. Activists’ pursuit of “short-term” agendas or distractions to Williams’ management preventing Williams from navigating the uncertain market; and
3. The risk that activists might effect a “lightning strike” accumulation of over 5% of its stock.⁶

The court found only one of the three threats as plausibly legitimate. First, the court found that the hypothetical threat of general stockholder activism was not a legitimate threat to the company justifying defensive measures.⁷ It noted that Williams’ board was not aware of any specific activity by activists and that stockholder activism is intertwined with the corporate franchise.⁸ The court said that it would require evidence of actual conduct by specific activist investors before such conduct could rise to the level of a cognizable threat.⁹ Similarly,

the court found that the asserted concern that activist investors might advocate short-term actions or be disruptive were theoretical and untethered to actual concrete events and, as such, not a cognizable threat in this case.¹⁰

However, the court did reason that using the plan as an “advance notice” pill to address perceived gaps in the federal disclosure regime applicable to stock accumulations by activists might be a legitimate response to conduct threatening an “orderly shareholder voice,” while expressing skepticism that a response as powerful as a poison pill could be used universally to meet such threat.¹¹

Assuming that the threat of a rapid, or “lightning strike,” share accumulation could present a cognizable threat justifying defensive measures, the court analyzed elements of the plan under the second *Unocal* prong to determine whether it amounted to a reasonable and proportionate response to such threat.¹² The court concluded the plan was not a reasonable response consistent with the board’s fiduciary duties, focusing on the following elements:

- **5% Trigger:** Except for pills used to protect net operating losses (“NOLs”) where tax laws justify use of a 5% trigger (not applicable here), the 5% trigger part of the plan was virtually unprecedented. Of the 21 pills adopted by companies during the first three months of the pandemic emergency, only one had a trigger that low, and it was a company facing an actual activist campaign by a 7% stockholder. Thirteen other companies facing ongoing activist campaigns selected triggers higher than 5%, usually in the 10%-15% range.¹³
- **Acting in Concert:** The so-called “wolf pack” provisions of this plan included not only express agreements but also parallel conduct

and swept up benign communications relating not just to changing control but also influencing control. It also included a “daisy chain” concept that could result in one stockholder acting in concert with another he does not even know exists simply by virtue of their separately and independently acting in concert with the same third party. Such a provision has a chilling effect on an activist’s ability to communicate with other stockholders.¹⁴

- **Passive Investor Exemption:** Although intended to ensure that truly passive investors were exempt from the 5% aggregation trigger, the exemption was defined in a way that would leave large institutional investors who acquire shares in the ordinary course and wish to communicate with management or other stockholders about the direction of the company subject to the plan’s restrictions.¹⁵

The court held that the plan’s combination of features could chill a wide range of stockholder communications and thus failed to fall within a range of reasonable responses to any threat posed.¹⁶

The Williams pill’s features, in combination and individually, were so “unprecedented” and “extreme” that it constituted one of the most restrictive COVID-era pills.¹⁷ So, the court’s ruling is a far cry from unraveling the tapestry of Delaware law permitting poison pills as proper defensive measures against specific threats of stockholders accumulating control without paying an appropriate control premium. However, the decision does underscore Delaware law’s stance that poison pills are powerful tools that may only be wielded in good faith and in the face of a cognizable threat. The essence of the shareholder franchise and the tenets of Delaware corporate law do not preclude all stockholder efforts to influence or change the direction of a company.

SEC Division of Examinations Announces 2021 Examination Priorities

On March 3, 2021, the Division of Examinations (“EXAMS”) (previously, the Office of Compliance Inspections and Examinations) of the SEC released its 2021 examination priorities (the “2021 Priorities”).¹⁸ The 2021 Priorities are organized into nine general areas:

Retail Investors, Including Seniors and Individuals Saving For Retirement. The 2021 Priorities include that EXAMS will focus on investments and services marketed to retail investors, including mutual funds and exchange-traded funds (“ETFs”), municipal securities and other fixed income instruments, variable annuities, private placements and microcap securities. EXAMS will also focus on compliance with Regulation Best Interest, Form CRS and whether registered investment advisers (“RIAs”) have fulfilled their fiduciary duties. With respect to fraud, sales practices, and conflicts, examinations will focus on assessing the appropriateness of recommendations made to retail investors, and particularly, recommendations made to seniors, teachers, military personnel and individuals saving for retirement.

Information Security and Operational Resiliency. Citing the increase in remote operations in response to the COVID-19 pandemic, the 2021 Priorities include that EXAMS will review whether firms have taken appropriate measures to: (i) safeguard customer accounts and prevent account intrusions, including identity verification to prevent unauthorized access; (ii) oversee vendors and service providers; (iii) address malicious email activities; (iv) respond to incidents such as ransomware attacks; and (v) manage operational risk as a result of dispersed employees in a work-from-home environment. Relatedly, EXAMS will also review business continuity and disaster recovery plans to

determine whether such plans account for growing physical and other risks associated with climate change. The 2021 Priorities also state that EXAMS will review whether systemically important registrants are considering effective practices to help improve responses to large-scale events.

Financial Technology and Innovation, Including Digital Assets. The 2021 Priorities note firms’ use of innovative technology to provide financial services to customers, including for example, “robo-advisers” and firms offering automated asset allocation, fractional share purchases, customized portfolios and mobile applications, adding that examinations will focus on evaluating: (i) whether firms are operating consistently with their representations, (ii) whether firms are handling customer orders in accordance with customer instructions, and (iii) compliance around trade recommendations made in mobile applications. EXAMS will also review firms’ implementation and integration of regulatory technology (“RegTech”) in compliance programs.

Anti-Money Laundering (“AML”). Under the Bank Secrecy Act, financial institutions, including broker-dealers and registered investment companies, are required to establish AML programs, including policies and procedures reasonably designed to identify and verify the identity of customers, perform due diligence, monitor for suspicious activity, and file suspicious activity reports (when appropriate), among other items. The 2021 Priorities indicate that EXAMS will continue to prioritize examinations of broker-dealers and registered investment companies for compliance with AML obligations.

The London Inter-Bank Offered Rate (“LIBOR”) Transition. EXAMS will engage with registrants through examinations to assess their understanding of their LIBOR exposure and their preparation for

the discontinuation of LIBOR and transition to an alternative reference rate.

Additional Focus Areas Involving RIAs and Investment Companies. EXAMS will continue prioritizing examinations of RIAs that have never or not recently been examined, with a focus on firms' compliance programs. Referencing the increase in RIAs offering sustainability-focused investment strategies, including environmental, social and governance ("ESG") focused strategies, the 2021 Priorities include that EXAMS will focus on products that are widely available to investors, including open-end funds and ETFs, as well as products offered to accredited investors. With respect to registered funds, examinations will focus on, among other items, funds' liquidity risk management programs. Additionally, EXAMS will review funds' and advisers' securities lending disclosure and practices. The 2021 Priorities also state that examinations of RIAs to private funds will review for preferential treatment of certain investors by advisers to private funds that have experienced liquidity issues, disclosure and compliance with respect to cross trades, principal investments, or distressed sales, and conflicts around liquidity, among other things.

Additional Focus Areas Involving Broker-Dealers and Municipal Advisors. Examinations of broker dealers will focus on the safety of customer cash and securities in accordance with the Customer Protection and Net Capital Rules; trading practices, including best execution; and alternative trading systems. EXAMS will also review how municipal advisors have adjusted their practices in response to the pandemic and its potential impact on advisers and their clients.

Market Infrastructure

Clearing Agencies: The Dodd-Frank Act requires

the SEC to complete annual reviews of registered clearing agencies that the Financial Stability Oversight Council has designated as systemically important and over which the SEC serves as the supervisory agency. In connection with such examinations, EXAMS will focus on, among other things, compliance, legal, recovery and wind down, margin, back-testing, settlement and operations, liquidity risk management, the effect of the transition away from LIBOR, and cybersecurity and resiliency.

National Securities Exchanges: Examinations of national securities exchanges will assess whether exchanges are meeting their obligations under federal securities laws, and will focus on exchange operations to monitor, investigate and enforce compliance with exchange rules and federal securities laws.

Regulation Systems Compliance and Integrity ("Regulation SCI"): Examinations will focus on whether designated entities, including national securities exchanges, certain clearing agencies, the Financial Industry Regulatory Authority ("FINRA"), the Municipal Securities Rulemaking Board ("MSRB"), plan processors, and certain alternative trading systems (SCI Entities) have implemented written policies and procedures in compliance with the requirements of Regulation SCI.

Transfer Agents: The 2021 Priorities include that EXAMS will review transfer agents' core functions, such as recordkeeping, safeguarding funds and securities, and the timely turnaround of items and transfers, but that in light of the pandemic, EXAMS will also review business continuity and disaster recovery programs as well as cybersecurity measures.

Focus on FINRA and MSRB. Among other items, EXAMS will focus on reviewing FINRA's major

regulatory programs and conducting oversight examinations of FINRA exams of certain broker-dealers and municipal advisors. With respect to MSRB, the 2021 Priorities state that examinations of MSRB will evaluate the effectiveness of its policies, procedures and controls.

ENDNOTES:

¹See *In re Williams Cos. Stockholder Litig.*, C.A. No. 2020-0707-KSJM (Del. Ch. Feb. 26, 2021), available at: <https://courts.delaware.gov/Opinions/Download.aspx?id=317240>.

²*In re Williams* at 2.

³*In re Williams* at 2.

⁴*In re Williams* at 2-3.

⁵*In re Williams* (applying *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985)).

⁶*In re Williams*. at 2-3, 74.

⁷*In re Williams* at 53-54, 64-71.

⁸*In re Williams* at 53-54, 64-71.

⁹*In re Williams* at 70-71.

¹⁰*In re Williams*. at 71-73.

¹¹*In re Williams* at 74-77.

¹²*In re Williams* at 77.

¹³*In re Williams* at 77-78.

¹⁴*In re Williams* at 83-88.

¹⁵*In re Williams* at 88.

¹⁶*In re Williams* at 88-89.

¹⁷See *In re Williams* at 78 n. 361, 88-89.

¹⁸See Press Re. No. 2021-39 (March 3, 2021), available at: <https://www.sec.gov/news/press-release/2021-39>; U.S. Securities and Exchange Commission, Division of Examinations, 2021 Examination Priorities (2021), <https://www.sec.gov/files/2021-exam-priorities.pdf>.