MORRISON
FOERSTER

Activists Increasingly Seek a "Second Bite at the Apple"

By Spencer Klein and Enrico Granata

In recent proxy seasons we have noticed an increase in the frequency of "second bite" proxy contests. These situations can take various forms, including (i) a second proxy contest by an activist that reached a settlement with the company in a prior year (*see, e.g.*, the contest launched in 2013 by Starboard to obtain additional seats on the board of Wausau Paper Corp.), (ii) an additional proxy contest launched by a shareholder that had previously unsuccessfully tried to appoint nominees to the board (*see, e.g.*, GAMCO's 2013 settlement with Myers Industries which followed four consecutive unsuccessful proxy contests), or (iii) a contest launched by a shareholder after the company has reached a settlement with another activist (*see, e.g.*, Emulex's potential proxy contest with Starboard following Emulex's settlement with Elliott Associates). While it is impossible to provide recommendations of general applicability since any strategic advice in the context of a proxy fight needs to be customized to the specific circumstances of the case, we have included below some considerations that might provide some preliminary guidance to companies to reduce the likelihood of a "second bite" situation.

- *The Settlement Decision*
    - While there are several reasons why a company may want to settle a proxy contest (*e.g.*, to eliminate distraction for the management team, minimize public criticism, avoid costs and mitigate the effects of a likely defeat), companies should also consider whether a settlement will likely be perceived as a defeat on the part of the company, whether it will boost the activist's reputation vis-à-vis other shareholders, and whether it will encourage other activist shareholders to target the company.
    - A thorough review of the company's shareholder base and latent threats by other activists should inform any settlement decision. In addition, the potential benefits of fighting on should also be taken into account, including whether showing the willingness to fight tenaciously when necessary may discourage future contests.
    - If a company chooses to settle, the settlement, and the public relations efforts accompanying it, should be part of a comprehensive strategy to avoid future threats. Settling should not be a way to kick the can down the road.
- *Number of Seats and Length of Standstill*
    - In the context of settlement discussions, negotiating the most limited level of minority board representation for the insurgent may not always be the best approach for the company. Management and the board should consider the expected timeline for implementing strategic and/or governance measures that will enhance the company's reputation with its shareholders, increase shareholder value and thus reduce both the risk of a repeat proxy fight with the insurgent following the expiration of the standstill period and the likelihood of activism by other shareholders.

  - Offering a greater level of minority board representation to the activist shareholder (*e.g.*, two seats instead of one) in exchange for a longer standstill period that would enable management and the board to implement such strategic and/or governance measures may be the preferable approach in some circumstances.

- *Direct or Indirect Representation*

  - Whether the settlement provides for the appointment of nominees affiliated with the activist, as opposed to unaffiliated nominees selected by the activist, will impact whether the settlement is perceived as an absolute victory by the activist, which could weaken the company's reputation and increase the threat of activism by others.

  - Consideration should be given to whether the activist should be offered a greater level of minority board representation in exchange for the appointment of nominees who would be perceived as independent members of the board.

- *Announcing the Settlement*

  - How the settlement is announced will have a significant impact on whether the company will be perceived as having capitulated to the activist's requests. The provisions of the settlement agreement setting forth the procedures for making public announcements regarding the settlement, including the content of the joint press release, should be carefully negotiated.

  - The press issued by the company should be a joint press release and, in addition to conveying the message that the proxy contest is over, it should also emphasize that the activist shareholder and the company have reached a meeting of the minds on how to increase shareholder value and have thus joined forces. This is particularly important if the contest was acrimonious with numerous fight letters exchanged between the parties. The press release should unequivocally portray the post-settlement relationship between the company and the activist shareholder as one of mutual cooperation towards increasing shareholder value.

  - In no event should the company fail to include a provision in the settlement agreement preventing the activist shareholder from issuing public statements that are inconsistent with or contrary to what is set forth in the press release.

- *Non-Disparagement Clauses*

  - Especially when the settlement follows an acrimonious proxy contest and the threat of a repeat fight is not unlikely, the company should request that a broad non-disparagement clause be included in the settlement agreement.

  - When properly drafted these clauses contain covenants by the activist shareholder not to engage in any conduct or communication that is likely to undermine or disparage or otherwise reflect adversely or detrimentally on the company or its directors and officers. Extracting this commitment from the activist may provide significant benefits when management and the board are trying to restore the company's reputation following a damaging proxy contest.

- *After the Settlement*
    - Making the insurgent's nominee(s) integral member(s) of the board and fully involved in all critical decision-making may go a long way towards reducing the threat of a repeat proxy contest upon expiration of the standstill period and forming a strategic partnership with the insurgent which may provide management with greater leeway in connection with the implementation of value enhancing measures.
    - Resisting a commitment on the part of the company to appoint the insurgent's candidates to the board's committees and other measures that may result in the disenfranchisement of the insurgent's nominees can often backfire.
    - Irrespective of whether the insurgent and the company have agreed on a specific timeline for the implementation of the governance or corporate strategy changes sought by the insurgent, the work of implementing agreed changes should start right away, so that there's a greater likelihood that the benefits of such changes will be tangible prior to the next annual meeting season.

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for 10 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.