

## Many Activist Investors Keep Coming Back for More

By Karen Kroll

When activist investors strike, there's often a sequel, even if a company has worked to address their concerns.

Boards and managements are often tempted to consider a matter closed, once they have engaged with an activist shareholder group, especially if they have made some concessions. While perhaps understandable, such an approach can backfire, say those who advise companies on working with activist shareholders.

"Don't ignore them and don't stonewall," says Spencer Klein, partner and co-head of mergers and acquisitions at the law firm Morrison & Foerster. "These investors tend to be aggressive, well-capitalized, and thoughtful. They won't just go away."

Moreover, just because a company and activist have settled doesn't mean the matter is closed for good. Many will continue to monitor the performance of the company and its stock, notes Andrew Bor, a partner with Perkins Coie, who has advised firms on working with activist shareholders.

As most compliance professionals know all too well, activism by investors has been on the rise. The number of interventions by activist shareholders across the globe jumped from 172 in 2010 to 323 for the first nine months of 2013, according to a report by the law firm Linklaters.

Along with more shareholder activism, some shareholders are targeting companies a second time. This includes shareholders that reach a settlement with a company and later request additional changes. Activist hedge fund Starboard Value, for example, has continued to press for changes at Wausau Paper, including demands to move the company headquarters, even after reaching a March 2013 agreement that put two Starboard-backed directors on Wausau's board.

Indeed, activist shareholders have shown greater staying power and savvy. Many are hiring financial advisers, using executive recruiters in order to attract

seasoned executives, and engaging public relations firms, says Richard Grossman, a partner at law firm Skadden, Arps, Slate, Meagher & Flom, whose practice includes advising companies on how to respond to shareholder activism. "They've become more sophisticated over the past few years."

### Serving Many Masters

Some companies are managing concurrent relationships with multiple activist shareholders. That's the case with Emulex Corp., a provider of network hardware and software. At least two activist shareholder groups have stakes in the company. As of mid-November, Starboard Value had a 4 percent share, while hedge fund Elliot Management Corp. had an 8.2 percent share.

At the same time, some institutional shareholders, such as public pension funds, have become more receptive to activist strategies, Klein points out. Some large pension funds, including the California Public Employees' Retirement System, are working with more traditional

hands-on, detailed, and analytical view of a company's performance," Klein adds.

While no public company can assume that it is immune to one or more engagements from activist shareholders, management can take steps to reduce the likelihood that it is targeted. First, engage shareholders. In cases where activist-backed directors come onto the board, "it's important to get those shareholders to be full-fledged, participating members of the board," Klein says.

### Communication Breakdown

If activist shareholders play a valid role in the board deliberations, they're often less likely to take their concerns and criticisms to outsiders. "Activist shareholders go public generally when the lines of communication with the company break down," says David Grinberg, partner and chair of the mergers and acquisitions practice with Manatt Phelps Phillips. Most prefer to negotiate in private, which is less costly and generally more conducive to ironing out differences.

Another top concern is avoiding the

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Spencer Klein, Partner, Morrison & Foerster

activist shareholders to push for changes at companies. They are also filing more shareholder proposals. A 2013 report by Proxy Monitor, "Public Pension Fund Activism," found that the New York State Common Retirement Fund had sponsored twelve shareholder proposals among Fortune 250 companies in 2013, up from just two in 2010.

Several drivers are behind this shift within institutional shareholders, including a greater focus on corporate governance and heightened skepticism about the performance of the board and management. "There's a greater willingness by institutional shareholders to take a more

perception that all the executives and board members are concerned with is keeping their own jobs, or that they're taking actions that are in the interest of themselves, rather than all shareholders, Grinberg says. If an activist attempts to nominate a board candidate, for example, with unique expertise in an industry in which the company operates and is rebuffed, the action becomes difficult to defend, Grinberg says. "It may be viewed as board entrenchment," he says.

Engaging shareholders may include conveying less-than-positive news about the company's performance, although ideally accompanied by a strategy for

improvement. “Be realistic and transparent, even if it’s not always good news,” Bor advises. Since many activists have a good idea of how a company is doing when compared to its peers, it’s best to acknowledge any under-performance, while also explaining how the company is addressing it.

#### To Settle, or Not to Settle

Although firm statistics are difficult to obtain, many companies end up settling with activist shareholders to avoid the cost and distraction of a prolonged battle. While settling can be an appropriate strategy, the way in which a settlement is reached, including what’s given up and how the agreement is characterized in public statements, will affect other activists’ perception of it. If handled poorly, it could be seen as a defeat for the company and may spark other activists’ attention, Klein says.

Any settlement agreement should include a standstill provision that’s extended for as long as possible. This provision typically states that for a period of time after the agreement is developed, the activist can’t, for instance, purchase more stock, solicit proxies, or join a group that will become activist. “Essentially, this says, ‘we don’t want you to cause trouble again for a period of time,’” Grinberg says.

Of course, coming to agreement on the terms and duration of the standstill provision involves negotiation. Most activists want to limit the duration of the standstill agreement. “Typically, activists want a lever to come back the following year if they’re not happy. It’s difficult to get multi-year settlements,” Grossman points out.

Conversely, the company will want to extend the standstill as far as possible, or at least through the next year’s annual meeting, Grinberg says. A shorter time frame provides little time to make any changes.

The duration of the standstill to which the activist will agree may depend on the other concessions the company makes, Grinberg says. For example, if the company gives up two board seats rather than just one, the activist may find it easier to agree to a longer standstill period. “The

company has to decide: Is it worth it to buy more time?” At the same time, management also has to consider whether al-

lotting the activist more board seats is likely to be seen as a sign of weakness by other activists, who then may also target

### ACTIVIST INVESTORS’ GLOBAL ACTION

Below are some key points from Linklaters’ recent report, “Activist Investors Turn Up the Heat in Global Boardrooms.”

- » Activist shareholders have ratcheted up their actions against companies globally by 88 percent between Jan. 1, 2010, and Sept. 20, 2013, with the majority of that growth in Europe and the United States.
- » Activist shareholders worldwide have stepped up their actions at mid and large-cap companies\* by 129 percent since January 2010.
- » The number of shareholders globally with a stated activist strategy has more than doubled over the last decade, with the result that their activity has become spread across a more diversified range of sectors than ever before, including services and technology companies.
- » The number of activist shareholders seeking to gain boardroom representation globally has jumped by 24 percent since 2010.

\*Companies with a market capitalization of greater than \$2 Billion

Companies are facing a sharp rise in actions by activist shareholders globally, as they seek to exert their influence on larger organizations, according to new research commissioned by Linklaters.

The global law firm found that the number of interventions by activist investors worldwide increased to 323 in the first nine months of this year, which is an 88 percent leap on the 172 in 2010. The United States still accounts for the lion’s share of these actions globally—after an 80 percent uplift in activist actions between January 2010 and September 2013—but Europe is also seeing rising levels of shareholder activism. Activist investors have stepped up their actions at companies in Europe by 62 percent over the same period ...

... The Linklaters’ research found that activists globally have increased their actions at large companies with market capitalizations of more than \$2 Billion by 129 percent since 2010 ...

... Activists seeking board representation globally outnumbered those pushing for share buy-backs—the next most popular action—by more than three to one in the first nine months of 2013. Since January 2010, the number of activists requesting a boardroom seat has jumped by 24 percent.

Globally, the pressure applied on directors is laid bare by activist shareholders this year launching more than twice as many campaigns to remove chief executives, or other board members, than in 2010 ...

... The activists’ traditional hunting ground has been the financial services sector, but as the number of shareholders employing activist strategies has increased steadily over the last decade, they have needed to diversify into other industries. Services companies globally accounted for 24 percent of activist actions in the first nine months of this year, while technology companies made up 22 percent of the total.

Source: Linklaters.

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the company, he adds.

Another area to consider is the confidentiality provision within the settlement agreement. If an activist shareholder or one of his or her affiliates gains a seat on the board, it's critical to have some assurance that the board can continue to conduct its business without information being leaked to outsiders in a way that's damaging or destructive to the company.

When a settlement is reached and an-

nounced, it should be done as a joint communication between the company and the activist, and emphasize the "meeting of the minds" between the two, Klein says. That is, the announcement should convey the message that the two now are working together in the interests of shareholders. In addition, the settlement agreement should prohibit the activist from issuing public statements that are inconsistent with the release or from otherwise disparaging the company or its directors, Klein

adds.

While all these tactics are critical, companies still need to remain vigilant, both about maintaining an ongoing dialogue with activists, and taking steps to improve performance. Indeed, the most effective way of quelling activists' concerns usually is to boost the company's results. "The easiest way to keep an activist from coming back is to perform well and have the activist feel like they've been a part of the process," Klein says.