

On April 3, 2014, Squire Sanders hosted a roundtable discussion, “The Activist Shareholder,” during its 2014 Roundtable for General Counsel in the Chemical and Performance Materials Industries, a two-day executive event held in Washington, DC.

The panel addressed the significant increase in shareholder activism in recent years, and examined shareholder activism from various industry expert perspectives, including that of Glenn Booraem, Principal and Fund Controller for Vanguard; Aeisha Mastagni, Investment Officer, Corporate Governance for the California State Teachers’ Retirement System (CalSTRS) Investments; Patrick McGurn, Special Counsel, Institutional Shareholder Services; Ann Yerger, Executive Director, Council of Institutional Investors; and Margaret Foran, Chief Governance Officer, Vice President and Corporate Secretary, Prudential Financial, Inc. and board member of Occidental Petroleum Corporation. The panel discussion was moderated by Abby E. Brown, Partner in the Global Corporate Practice of Squire Sanders.

Companies That Are “Tasty” to an Activist Shareholder

Shareholder activism is prevalent. In their remarks, Ms. Yerger stated that we are in a period of “energized” activism and Mr. McGurn indicated that the “gold rush” of shareholder activism has brought many new players into the field, and that “no one is immune to activism.” Ms. Foran explained that some companies in particular are “tasty” to shareholder activists.

Mr. McGurn discussed a number of factors that could make a company particularly “tasty:”

- Having large amounts of cash on the books, whether in the US or abroad, may attract “balance sheet activism,” with activists requesting that companies put that money to work through techniques such as special dividends, raising existing dividends or share repurchases;
- If the market has placed a discount on a portion of a company’s assets relative to its other assets, that may attract “operational activism,” with activists seeking to change the company’s strategy;
- Engaging in public company mergers and acquisitions is likely to attract investor interest, such as investors potentially taking action to try to achieve a higher purchase price;
- Having a record of poor (or even just less than stellar) corporate governance may attract activists looking to change senior management and/or the board of directors composition; and
- Having a history of early settlements with activist shareholders may unintentionally attract further activist efforts.

How to Make a Company “Unappetizing” to Shareholder Activists

In order to make themselves “unappetizing” to activist shareholders, one of the most important tasks is for companies to communicate and engage with investors in a meaningful and respectful manner. The panelists shared some helpful tips on how to foster effective communication with institutional shareholders:

- Companies should be responsive to their investors. Ms. Mastagni stressed that if an investor group calls or sends a letter raising an issue of concern, the receiving company should respond, and noted that a surprisingly large number of companies fail to respond when CalSTRS sends initial inquiries to them.
- Companies should proactively connect with their large investors—preferably early on and regularly—so that the company has room to take actions, make mistakes and ask for feedback. As a result of a developed relationship, those investors may come to the aid of the company when needed in an activist shareholder situation. A prime example, as pointed out by Ms. Foran, is the California Public Employees’ Retirement System’s (CalPERS) support of Apple in its battle with Carl Icahn (who supported a non-binding shareholder proposal for Apple to engage in a US\$50 billion buyback program).
- In its communications, it is critical for a company to understand the issues that are most important to its institutional investors, and then stylize its responsive approach accordingly. For example, on matters such as executive compensation and contested election issues, institutional investors will want to speak directly to members of the board. Ms. Mastagni recommended that every board of directors should have one or two directors that can be “camera ready” to clearly communicate the company’s strategy to shareholders. In connection with this, companies need to constantly re-evaluate the mix of the board to see what may be working against it, and assess whether the board has the best suited people to serve. Ms. Mastagni advised that, if a company cannot clearly articulate why a director is well-suited to serve on its board, there is probably an issue. Mr. McGurn indicated that in proxy contests, activists tend to apply the “eyeglasses test” by matching up their nominees’ industry experience against a company’s sitting directors.
- Ms. Yerger conveyed that, in addition to discussions with investors, high-quality disclosures themselves are essential communication tools to warding off activists and should not be discounted.

How to Deal With Activists at Your Doorstep

Where companies cannot, despite best efforts, prevent shareholder activism, they need to effectively deal with the activism at hand. The panelists made a number of recommendations in this regard:

- Ms. Yerger advised not to let small issues become bigger ones; companies should be sure to deal with potential activism when it first arises.
- Mr. McGurn recommended that companies should avoid being impulsive or having a “knee jerk” reaction to activists. Making impulsive changes to quickly rid the company of an activist investor’s attention may cure a short-term issue, but is likely to lead to further, bigger problems down the road.
- Mr. Booraem suggested that, when approached by an activist, a company should clearly communicate its perspective regarding the perceived problem to other key investors to avoid overreacting to the views of one constituency.
- Mr. McGurn agreed in observing that, in connection with generating a strategy to address the activist concern, companies should ask other key investors if they agree with the changes that an activist proposes.

Shareholder Activism – Today and Beyond

Shareholder activism will undoubtedly play a key part in the current 2014 proxy season. Ms. Foran shared that, in addition to those aspects previously discussed, tenure and board diversity will continue to be hot topics for institutional shareholders for the next several years. Mr. McGurn predicted that mid-cap companies with plurality voting and classified boards will continue to face pressure to adopt majority voting and to declassify boards. Both Ms. Mastagni and Mr. Booraem explained that institutional investors such as their firms apply their own internal tests to determine which companies to reach out to and request change. For example, Ms. Mastagni indicated that each year CalSTRs looks at which Russell 2000 companies in its portfolio lack majority voting or a de-staggered board and where CalSTRs has the largest holdings by shares outstanding. Of those companies, CalSTRs will send a letter to a designated number, asking whether the board has looked at the issue. Similarly, Vanguard looks closely at companies that, among other things, lack majority voting and/or still have classified boards, coupled with those firms where Vanguard has the most significant dollar investments and/or the most significant portion of the company’s outstanding shares. Those companies where Vanguard has the most at stake are the most likely candidates for outreach seeking change.

If you have questions about shareholder activism or concerns about how it could affect your business, please contact one of the individuals listed in this publication.

Contacts

Abby E. Brown

T +1 703 720 7894

E abby.brown@squiresanders.com

Carolyn J. Buller

T +1 216 479 8528

E carolyn.buller@squiresanders.com

Wendy K. LaDuca

T +1 703 720 7858

E wendy.laduca@squiresanders.com