

Abby E. Brown and Wendy LaDuca of the Global Corporate Practice at Squire Patton Boggs look at how the global chemicals industry can respond to activist shareholders

The relatively recent rise in shareholder activism has been attracting a lot of attention. Since the global financial crisis, the phenomenon of major investors using their equity stake to campaign for changes in corporate policy, finances and strategy has increased. The trend, already highly visible in the US, is spreading across Europe and elsewhere.

No industry appears exempt when it comes to activism and the global chemicals sector has also been feeling the effects. But exactly what kind of company is it that investor activists are most interested in? And how does a company deter such intervention and how should it deal with activists when they come knocking?

These particular questions were the focus for a detailed discussion on 'The Activist Shareholder' that Squire Patton Boggs' Chemicals Industry Group held at its annual Roundtable for General Counsel in the Chemical & Performance Materials Industries. This was held in Washington, DC, during the proxy season in early April.

We drew together a panel of experts in investment funds, financial services, corporate governance and proxy shareholder advice, to reflect on the significant increase in shareholder activism in recent years and assess from their specific industry perspectives how companies in the chemicals sector should be reacting.

'Tasty' Companies...

The roundtable speakers agreed that we are now in a period of 'energised' activism and recent events have shown that many new players have entered the field with the result that no company is immune to activism. Margaret Foran, chief governance officer at **Prudential Financial**, described certain companies as being particularly 'tasty' to shareholder activists. Inevitably a number of factors could make a company 'tasty'.

For instance, explained Patrick McGurn, special counsel at advisory group **Institutional Shareholder Services**, 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". Also, 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.

Likewise, engaging in public company M&A is likely to attract investor interest. In such scenarios, investors might be tempted to take action to try to achieve a higher purchase price. A company that has a record of poor - or even just less than stellar - corporate governance may also attract activists looking to change senior management and/or the composition of the board of directors. Finally, having a history of early settlements with activist shareholders may unintentionally attract further activist efforts.

...And How Not to Be One

In order to make themselves 'unappetising' to activist shareholders, one of the most important tasks for companies is to communicate and engage with investors in a meaningful and respectful manner. There were several helpful tips from the panel on how to foster effective communication with institutional shareholders.

Companies should certainly be responsive to their investors. Aeisha Mastagni, investment officer for corporate governance for California State Teachers' Retirement System (**CalSTRS**) Investments, stressed that if an investor group calls or sends a letter raising an issue of concern, the receiving company should respond. A surprisingly large number of companies fail to respond when CalSTRS sends initial inquiries to them.

A company should also connect proactively with their large investors – preferably early on and regularly – so that it 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, panellists agreed.

In its communications, it is critical for a company to understand the issues that are most important to its institutional investors, and then stylise 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. "Every board of directors should have one or two directors that can be 'camera-ready' to communicate the company's strategy clearly to shareholders," said Mastagni.

In connection with this, companies need to re-evaluate the mix of the board constantly in order to see what may be working against it and assess whether the board has the best suited people to serve. If a company cannot clearly articulate why a director is well-suited to serve on its board, there is probably an issue. In proxy contests, McGurn observed, "activists tend to apply the 'eyeglasses test' by matching up their nominees' industry experience against a company's sitting directors."

In addition to discussions with investors, high-quality disclosures themselves are, stressed Ann Yerger, executive director of the **Council of Institutional Investors**, "essential communication tools for warding off activists and should not be discounted."

Activists at Your Doorstep

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

Firstly, do not let small issues become bigger ones. Companies should be sure to deal with potential activism when it first arises. They should also avoid being impulsive or having a kneejerk 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.

When approached by an activist, a company should clearly communicate its perspective regarding the perceived problem to other key investors to avoid, as Glenn Booraem, principal and fund controller at **Vanguard**, put it, "overreacting to the views of one constituency." And, in connection with generating a strategy to address the activist's concerns, companies should ask other key investors if they agree with the changes that an activist proposes.

Today & Beyond

Shareholder activism will undoubtedly play a key part in forthcoming proxy seasons and AGMs. In addition to the issues discussed above, companies in the chemicals sector may well find that tenure and board diversity continue to be hot topics for institutional shareholders for the next several years, while mid-cap companies with plurality voting and classified boards continue to face pressure to adopt majority voting and to declassify boards.

According to Mastagni and Booraem, institutional investors such as their firms apply their own internal tests to determine which companies to reach out to and request change. For example, according to Mastagni, 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. It will then send a letter to a designated number of these, 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 it has the most significant investments in dollar terms and/or the most significant portion of the company's outstanding shares. Those companies where it has the most at stake are the most likely candidates for outreach seeking change.

Clearly shareholder activism is a complex phenomenon that public or listed companies in all sectors have to be mindful of. While there may not be a simple solution to dealing with the issue, following best practice in your corporate governance and showing all investors the attention and respect they deserve are vital.

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