



New Tactics and ESG Themes Change the Direction of Shareholder Activism

Posted by Richard J. Grossman and Neil P. Stronski, Skadden, Arps, Slate, Meagher & Flom LLP, on Friday, February 26, 2021

Editor's note: Richard J. Grossman and Neil P. Stronski are partners at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum. Related research from the Program on Corporate Governance includes [The Long-Term Effects of Hedge Fund Activism](#) by Lucian Bebchuk, Alon Brav, and Wei Jiang (discussed on the Forum [here](#)); [Dancing with Activists](#) by Lucian Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch (discussed on the Forum [here](#)); [The Illusory Promise of Stakeholder Governance](#) by Lucian A. Bebchuk and Roberto Tallarita (discussed on the Forum [here](#)).

Takeaways

- Activism is likely to rebound as the business world recovers from COVID-19 disruptions.
- Some activists are raising permanent capital, giving them new leverage, and activist approaches have become more acceptable to many institutional investors.
- Even high-performing companies may face pressure on ESG issues.
- The best defense is a solid relationship with and understanding of your shareholders, coupled with a plan for dealing with activists if they emerge.

Shareholder activism levels decreased in 2020 amid the upheaval and uncertainty brought on by COVID-19. But activists did launch a number of high-profile campaigns and there was an uptick of activism in the second half of the year; and more than 80 CEOs were replaced during activist campaigns.

Today, even well-performing companies may find themselves targets of activist campaigns on environmental and social issues, as new funds have been formed to specialize in these areas. Moreover, established activists have established new types of investment vehicles that could strengthen their hands. Preparing for the possibility of an activist campaign should therefore be on the board agenda at most public companies.

Expect an uptick in activism in 2021. Historically, many activist campaigns have focused on M&A and returns of capital. The economic uncertainty and liquidity issues companies faced in 2020 reduced M&A activity and made it harder for activists to advocate transformative deals, such as the sale of a company, a breakup or major divestiture, or a large dividend payout. In addition, there were fewer announced deals for activists to challenge.

As the economy rebounds and business becomes more predictable, activists are likely to press companies to undertake transactions and advocate for changes to the deals companies propose.

COVID-19 problems may spur some campaigns. Underperformance is another traditional target of activists. As businesses struggle to cope with the challenges of the pandemic, or if a company's stock price does not return to pre-pandemic levels, some could find themselves vulnerable to activists pressing for operational or governance changes.

Even companies with solid financial performance may face activists. Environmental, social and governance (ESG) themes featured prominently in 2020 activist campaigns, and several factors are likely to accelerate that trend.

Many institutional investors, even managers of passive index funds, have called for the business world to address environmental and social issues such as diversity. (See “[ESG: Many Demands, Few Clear Rules](#).”) Major American and European oil companies, for instance, have been pressed to lower their emissions by activist groups that are backed by major pension funds and asset managers.

Some established activists have recently formed ESG-focused funds alongside their regular pools to target companies they contend have not met ESG standards, and some veteran activists, including ValueAct founder Jeff Ubben, have formed new ESG-only activist firms. Other new ESG funds have been formed by groups with few ties to established activist firms.

Boards need to prepare for this new set of players and their agendas, paying close attention to their companies' ESG profiles and ratings, and not just the financial vulnerabilities that traditionally attracted activists' attention.

The lines between activists and other investors are blurring. A number of major activist firms have begun acting more like private equity firms, pursuing outright acquisitions or negotiating for large stakes in companies for extended periods (private investments in public entities, or PIPEs). In 2020, three of the best-known names in activism, Pershing Square, Starboard Value and Third Point, formed SPACs (special purpose acquisition companies), shell companies that raised capital to buy businesses. One of the most influential established activist firms, Elliott Management, formed a buyout fund in 2019.

Meanwhile, some private equity firms have pursued more activist-like strategies, and in some cases, activists have teamed up with strategics or private equity firms on acquisitions. Since activists often zero in on management and operational shortcomings, a buyout is a logical next step.

These moves may alter the calculus for companies in some situations, because an activist investor with sufficient capital and a proven willingness to take a long-term position in a company or to take it private poses a more serious threat than one known only for saber-rattling and then trading out of the stock.

Traditional investors have become more open to activism. Over the last few years, as activism has become more accepted, some long-only asset managers, including money managers, have supported activist campaigns where they thought it would increase the value of their investments. Usually, this has been behind the scenes, but some traditional asset managers have now openly adopted activist tactics. For example, Wellington Management, the largest

shareholder of Bristol-Myers Squibb, came out against the drugmaker's \$74 billion deal to buy biotech Celgene in 2019.

This reflects a broader transition to a more shareholder-centric model of corporate governance. Potentially, any investor with a clear agenda, sufficient resources and the support of a wide shareholder base can utilize activist tactics.

Framing a Strategy

Given the evolution of activism, it is vital for boards to ensure that their companies have strategies to address activist pressure.

Shareholder engagement is the best defense. Ongoing dialogue with shareholders is the best preventive strategy. Know your most significant shareholders and understand their investment theses. Engagement with shareholders more broadly allows management to build relationships, articulate the company's strategy and establish the credibility that management and the board will need in the event an activist surfaces.

Executives usually take the lead in communications with shareholders, but direct engagement by independent directors is becoming more common, particularly regarding subjects under the board's purview, such as executive compensation, capital allocation and succession planning, and when a company is facing major challenges. A company needs to weigh the pros and cons of using a director in this role, and give careful thought to the choice of directors and prepare them thoroughly.

Assess vulnerabilities and prepare responses. Proactively review your company's vulnerabilities ahead of any activist approach, looking at the business from the activist's perspective. Consider whether alternative financial and business strategies (say, a divestiture, spinoff or enhanced return of capital) could boost shareholder value. An open-minded review can go a long way toward reducing the risk of an activist intervention.

Develop a defensive plan. Implement a stock surveillance warning system to monitor new shareholdings, have a shareholder rights plan ready to implement if an activist acquires a substantial stake, assemble a team of advisers and prepare a playbook in case an activist emerges. Another tool being used more frequently is a "table-top" simulation of different activist scenarios to test and refine a company's reactions.

Early board involvement is critical. If an activist surfaces, it is crucial that management alerts the board immediately so directors are educated and are actively involved in the response. To avoid missteps, the board and management must be aligned in their approach and coordinate both internal and external communications.

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Activist Campaigns January-December 2020

