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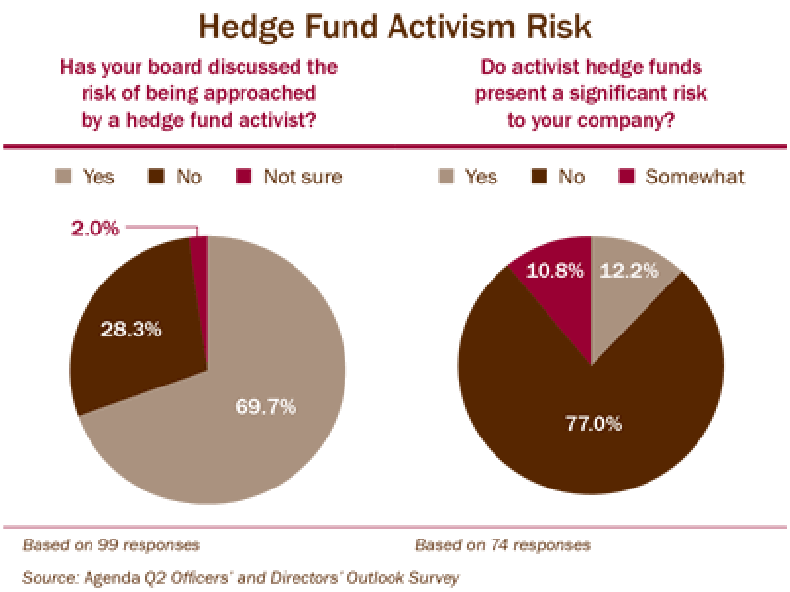
Activist Threat Drives Board Discussions

By Melissa J. Anderson June 6, 2016

Boards are discussing potential activist overtures, even if they don't think their company is at risk of an approach by an activist, according to *Agenda*'s recent Directors' and Officers' Outlook Survey.

More than two thirds (69.7%) of respondents to the survey said their board had discussed the risk of being approached by a hedge fund activist, but only 23% said they felt hedge funds presented a moderate or high risk to their company.



Last year, activists launched a record 376 campaigns against companies, and two thirds of those campaigns (249) were led by hedge funds, according to data from **FactSet**.

Experts say boards are becoming increasingly savvy in their preparation and response to the activist threat. But, they say, activist demands are becoming increasingly unpredictable, and boards should prepare for attacks beyond typical gripes over executive compensation, cash allocation or company structure. Activists are also waging campaigns related to governance and board composition.

For example, 41% of activist campaigns against U.S. public companies last year were board-related, according to research by **PwC**. Twenty percent of respondents to PwC's 2015 Directors and Officers survey said they had changed their board composition in response to actual or potential activism.

According to FactSet's research, hedge funds are the driving force behind activist-related board turnover. The vast majority — 80% — of board seats won by activists last year resulted from campaigns launched by hedge funds.

According to research by law firm **Schulte Roth & Zabel**, last year saw the highest number since 2010 of activist campaigns that were resolved by companies' meeting at least some aspect of activists' demands. Recently, high-profile activist campaigns were settled by **Avon**, **United Airlines** and **Yahoo**.

Board Discussions

Although *Agenda*'s survey suggests that two thirds of directors are discussing the risk of activist attention, some experts are surprised that number isn't higher.

"I can't conceive that there's a board today that doesn't consider the prospect of an activist approach," says **Adel Aslani-Far**, a partner in law firm **Latham & Watkins**'s New York office and former global co-chair of its mergers and acquisitions practice.

While activists previously focused on companies they believed to be underperforming, that's no longer the case as new hedge fund activists have crowded into the market in recent years, Aslani-Far says. Boards can't make the mistake of thinking their companies are unassailable just because they are performing well, he explains. Similarly, over the past five years, activist campaigns have changed tenor as investor expectations of engagement have grown.

"I think activists matured in the sense that they realized getting personal and petty wasn't the path to success, and that human beings would react a certain way when they were attacked personally," Aslani-Far says. "And at the same time, I think boards began to understand and appreciate the benefits of engaging."

In fact, one way boards can prepare for an activist campaign is to listen to other investors, says **Doug Chia**, executive director of **The Conference Board** Governance Center.

"They have probably already received feedback from the investor community in terms of what people think they should be doing with the business," Chia says, adding that while they will obviously receive conflicting points of view on this, each criticism could be an entry point for activists. It's better to have discussed the issue internally before it arises in an activist context, he says. Similarly, issues that have received relatively slight attention from activists in the past, such as corporate governance, are now being seen as an entry point for a campaign, he says, so boards shouldn't take complaints in this realm lightly.

"There's always going to be some soft spot for an activist to poke at, and a lot of activist campaigns focus on specific board members in terms of who they target … for public scrutiny," Chia says.

In discussions about activists, boards should communicate frankly about which directors could be a lightning rod for activist criticism, however unpleasant those talks might be, Chia says.

Experts say boards should also designate a point person to lead communication with a potential activist. The natural choice could be the chair or lead director, but, says **Jason Frankl**, senior managing director at **FTI Consulting** and leader of the firm's activism and M&A solutions practice, boards should also consider individual board members' personalities when determining who might be best suited to communicate with activists and other shareholders.

“A lot of management teams worry about the sensitivities associated with these things, and worry about putting them down on paper … but that really limits their ability to be honest with themselves,” Frankl says. “Doing planning work under legal privilege can oftentimes be very helpful as well.”

Investor Base

Finally, boards should examine their shareholder base to track investor sentiment and determine whether shareholders could be persuaded to team up with activists, Chia suggests. Similarly, they should ensure they are monitoring stock trades, experts say.

Currently, activists can amass up to 5% of a target company’s stock for 10 days before disclosing their position, and some Democratic lawmakers have vowed to change that. The Brokaw Act, proposed in March by Sen. **Tammy Baldwin** (D-Wis.) and Sen. **Jeff Merkley** (D-Ore.), would slash that window to two days.

“This legislation updates Depression-era rules to address the financial abuses being carried out by activist hedge funds who promote short-term gains at the expense of long-term growth,” Baldwin said in a press release. “The Brokaw Act will take on a rigged game by increasing transparency and strengthening oversight of activist hedge funds.”

Prominent hedge fund activists are now banding together to oppose the legislation, forming the **Council for Investor Rights and Corporate Accountability** (Circa). Circa is a nonprofit 501(c)(6) trade organization that will tout the potential benefits of activist investing, a spokesman for the group says.

Other details about the group are slim, but news reports have pegged its founders as **Paul Singer** of **Elliot Management Corp.**, **Carl Icahn** of **Icahn Associates**, **Barry Rosenstein** of **Jana Partners**, **Bill Ackman** of **Pershing Square Capital Management** and **Daniel Loeb** of **Third Point**.

According to the group’s website, besides lobbying and educating lawmakers about activist investing, Circa will also appeal to boards of public companies, although its spokesman says the group does not plan to focus on this area for some time.

The Conference Board’s Chia notes that he finds it curious that the group would be so tight-lipped about the details — including its staff, contact and governance information.

“These are things shareholders have demanded of companies and trade associations,” he says. “I think their credibility is undercut by the fact that Circa does not provide transparency, at least at this point.”