

## **Shareholder Activism in the COVID-19 Era**

Sam Gandhi, Beth Berg and Kai Liekefett

July 2020

### **Sam Gandhi:**

The COVID-19 pandemic poses unprecedented challenges for businesses and their boards of directors. One of the critical matters boards always contend with is the threat of shareholder activism, and now there's increased scrutiny of how well businesses are managing the COVID-19 crisis, how are activists responding, and how can companies plan and react effectively against the threat of shareholder activism. We'll find out in today's podcast.

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### **Beth Berg:**

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### **Kai Liekefett:**

Action item number one is you ought to assemble your response team right now.

### **Beth Berg:**

Activists will use any ammunition they can, and it's very easy to look back at what companies did and did not do and second guess them.

### **Sam Gandhi:**

From the international law firm Sidley Austin, this is the Sidley Podcast, where we tackle cutting edge issues in the law and put them in perspective for businesspeople today. I'm Sam Gandhi.

Hello, and welcome to this special edition of the Sidley Podcast. It's part of Sidley's ongoing efforts to help you stay on top of the legal developments during the coronavirus crisis. You can find more information in our COVID-19 Resource Center at [Sidley.com](https://www.sidley.com). Today we focus on the impact of COVID-19 on shareholder activism, and I'm joined by Sidley partners Beth Berg and Kai Liekefett. Beth has over 18 years of experience in advising companies on shareholder activism, proxy contests, and takeover defense. She also advises companies and boards of directors on mergers and acquisitions, spin offs, corporate governance, and SEC disclosure matters, and she's a partner in our firm's Chicago office. Kai is a partner in Sidley's New York office, and cochairs the firm's shareholder activism practice. He has 20 years of experience and focuses his practice solely on activism campaigns and proxy fights. In the last five years, he has been involved in over 50 proxy contests, more than any defense attorney in the country. Beth

joins us from Chicago and Kai joins us from New York. Beth and Kai, it's great to speak with you today.

**Beth Berg:**

Great to be here.

**Kai Liekefett:**

Thanks for having us.

**Sam Gandhi:**

Shareholder activism has always been a significant concern in the corporate landscape, and it's more particularly concerning in this new COVID-19 landscape. Knowing what to tell businesses and their boards of directors about what they need to do to protect themselves in this particularly hostile environment is just hugely valuable. Kai, how's the COVID-19 pandemic impacted the 2020 proxy season?

**Kai Liekefett:**

The pandemic has absolutely impacted the 2020 proxy season in a most unprecedented way. The background here is that the vast majority of public companies in the US, they hold their annual shareholder meeting between April and June, and most of these companies require in the bylaws advanced notice of director nominations by shareholders. These nomination deadlines are typically between January and March. In other words, when the coronavirus arrived in the US, that was the time of the year when activists work to force, to put up or shut up, and it is important to understand that once an activist launches a proxy contest to replace directors, an activist must be prepared to remain in the stock for the foreseeable future, at least until the annual shareholder meeting, and sometimes 6 to 12 months beyond that.

So, while there are no legal restrictions to the contrary, as a practical matter, an activist cannot initiate a proxy contest and then sell its position shortly afterwards. An activist who does that would lose credibility with long term institutional investors and becomes more susceptible to being portrayed as a short-term investor. As a result of these factors, a lot of activists decided in March when the nomination deadlines were up not to nominate. A lot of other activists who had nominated decided to quickly seek settlements with companies because they were concerned about having to commit to a stock in light of the more enormous volatility in the stock market, in particular in March, April, and the beginning of May.

So, we have seen the lowest number of proxy fights in over 20 years in the United States as a result of these factors. The few proxy fights that went forward were primarily companies with lower market caps, but while we at Sidley are pretty proud that we defended 10 proxy fights and lost none of them during this time, we will note that there was a high percentage of successful change of control fights among those few proxy contests that went all the way, and we should also note that there was one activist in

particular who was less concerned about pressing forward with a campaign during the middle of this crisis and that was Starboard, which launched a proxy fight.

**Sam Gandhi:**

Does that mean, Kai, it was just the timing of the pandemic that really affected the proxy season? If the pandemic had happened a little bit earlier or a little bit later it would have changed?

**Kai Liekefett:**

That was a major factor. Another factor is that some activists, not all activists, have the fear, which I think is justifiable, that pressing forward with a campaign in the middle of this humanitarian economic catastrophe would make them look tone deaf. Although, those activists who did proceed with their contests found oftentimes, in particular in cases where there were extreme cases of bad corporate governance and underperformance, that the likes of ISS, Glass Lewis, and institutional investors would support those campaigns, even in the middle of this crisis here.

**Sam Gandhi:**

So, Beth, I want to talk to you about how the activist playbook has changed in light of this pandemic. How have activists changed how they move forward just given the turmoil that Kai just reflected on?

**Beth Berg:**

Well, I see three big changes in the typical activist playbook, Sam. First, I think there will be a pause on overt balance sheet activism. When the pandemic hit back in March, cash was king, and companies that had resisted activist pressure for the return of cash to shareholders were really vindicated. Companies that had little cash and limited access to credit have paid a severe price. So, as long as boards, management teams, and investors remember the liquidity crunch many companies have faced in connection with the COVID pandemic, there will be less tolerance for calls for share repurchases and special dividends.

The second big change is probably a decline in M&A activism just because M&A volume remains low, and this is counter to the trend we've been seeing in recent years where there's been a rise in the number of instances where activists have challenged announced deals, and then finally, there is likely to be a shift in the timing of activist campaigns. Like Kai was saying, shareholder activism is largely driven by annual meeting calendars. Most companies have annual meetings in the second quarter, and the largest number of public companies have nomination deadlines in February and March. So, this was exactly when the pandemic was hitting Europe and the United States, and as Kai was saying, it led to many fewer proxy contests this year. Because of this timing dynamic, activists missed this annual meeting season, and so they'll either need to be very patient and wait until next year's proxy season, or pivot to off-cycled fights through consent solicitations or special meetings to effect change before that

time. So, unlike in prior years, companies should not relax after their 2020 annual meetings. We could be in for some action over the summer and into the fall.

**Sam Gandhi:**

So, Kai, corporate America's dealing with a lot lately. They're dealing with the pandemic. They're dealing right now with a prevalence of civil unrest and the concerns in the country that basically the majority of the country thinks the country's on the wrong track. So, what should companies really be doing right now? Should they be focusing on activism with all these things going on?

**Kai Liekefett:**

Yeah. That's a very good question, Sam, and the reality is that obviously there are a lot of priorities that should be higher at the company right now. Mostly, obviously the safety of everybody, the customers, the employees, and obviously comparably companies need to focus on making sure that they stay out of Chapter 11 and that they are able to adjust to this new normal that we are experiencing these days. Having said all that, unfortunately activists are not going to give companies a lot of time to adjust. What we have heard anecdotally is that a lot of activists are already raising capital to pursue new campaigns, that there are a lot of activists who are already building stakes. We know that for sure, and some activists, marquee activist names have already started to approach companies privately.

So, the reality is while there are a lot of more important things, activism is not going to fade away and remains a real threat, in particular for companies that are very vulnerable. So, who is particularly vulnerable right now? So, first and foremost, companies need to compare their total shareholder return, or TSR, against the TSR of their peer companies. What ISS and Glass Lewis and therefore also activists are looking at is how is the company's TSR on a one, three, five year trading basis as it compares to its peers, and if your company's significantly underperforming your peers, you are in the crosshairs, I can assure you that. Then, you need to look at your corporate governance. What is your corporate governance towards ISS? Are there any frequent concerns or complaints you receive over certain corporate governance practices? Because these are extremely important issues for ISS, Glass Lewis, and a lot of institutional investors, and therefore, activists like to exploit these kinds of topics in a campaign and are screening target companies or potential target companies for these issues.

Another item that attracts activists is CEO succession. If you have a CEO that is overdue to retire and/or you are in the middle of a CEO search, that typically attracts activists as well, and this all leads into a major issue that has been observed over the last couple of weeks in corporate America that companies have been slower to refresh their boards, and the entry point for a proxy contest threat is always the threat to replace a board, and it is easier to make that threat credibly for an activist if your average board member has a tenure that is significantly higher than 10 years, and if you have several board members who have above 10 years, I can assure you, you are going to be in the

crosshairs of an activist, and a lot of companies during this crisis have decided to put the pause button on board refreshment. That is something you should be very wary of.

**Sam Gandhi:**

We've talked a lot about how activists may see COVID as accelerating what's already some mismanagement, lack of succession, maleficence at the corporate level, but do you see a situation where activists may go after a company with the allegation that they haven't handled the reaction to COVID well?

**Kai Liekefett:**

Yes. Absolutely. So, in fact, I have a recent example where an activist director resigned last week from a board of directors, and he issued a public letter, and I'll just quote one sentence from that letter. "In October, we discussed my letter to the board in which I expressed my concerns regarding the company's direction and the dangers of continuing with the board's strategy at the time. Had swift action been taken at that time, the company would have been in a much better situation coming into today's COVID-19 crisis." So, this is the kind of topic I think we're going to hear over and over again in the next 12 months, that activists will claim, fairly or not, that certain companies are not handling the crisis as well as they should have and therefore are ripe for change.

**Beth Berg:**

Yeah. I absolutely agree with that. I think that activists will use any ammunition they can, and it's very easy to be an armchair quarterback here and look back at what companies did and did not do and second guess them, and use that as fodder for campaigns.

**Sam Gandhi:**

So, Beth, is there anything a company can do? Advertise, or have a better PR campaign about the things that they're doing to combat COVID and to take care of their people and their customers and their vendors?

**Beth Berg:**

Yeah. Typically, it is good to get out ahead of the situation and communicate to investors and other constituents exactly what the company did and did not do and why, and even admit that the company was doing the best that it could. It may not have done everything perfectly in retrospect, but it was acting at a time of crisis and communicate that clearly.

**Sam Gandhi:**

You're listening to the Sidley Podcast, and we're speaking with Sidley partners Beth Berg and Kai Liekefett on the impact of COVID-19 on shareholder activism. Beth advises companies on shareholder activism, proxy contests, and takeover defenses, and Kai cochairs Sidley's shareholder activism practice and focuses his practice solely on activism campaigns and proxy fights.

Now, many companies are simply trying to survive COVID-19, but they've also got to focus on how effectively they're navigating the pandemic, and more importantly whether their response plan also positions them for growth beyond the crisis, and also they have to keep defenses against potential shareholder activism. So, Beth, it's been all over the news lately that many companies are still adopting new poison pills in connection with the COVID-19 crisis as part of their annual meetings. Can you explain the background for this poison pill wave?

**Beth Berg:**

Sure. So, you're right. Companies have been adopting shareholder rights plans, otherwise known as poison pills, at rates we haven't seen in a very long time. To put some numbers on it, from March 1<sup>st</sup> to June 15<sup>th</sup>, at least 57 companies had adopted a rights plan. This is a lot considering that at the end of 2019 only 25 of the S&P 1500 had a rights plan in place, and what's so unusual is that more than three quarters of the companies that have adopted a rights plan since March 1<sup>st</sup> have done so in the absence of a specific takeover or activist threat.

So, to your question, what's fueling the adoption of rights plans these days? I'd point to a few things. First and foremost, an acute feeling of vulnerability ran through corporate America in March. The steep stock price declines made many companies attractive targets for activists and hostile acquirers, and the market volatility and high trading volumes we experienced in March made it even more difficult than usual to detect accumulations in a company's stock. Even in normal times, detecting rapid accumulations can be difficult, not only because it's not a science but rather an art, but also because of the use of derivatives by activists and others to circumvent SEC and HSR reporting requirements. So, everybody's feeling very vulnerable.

Another factor at work was that the proxy advisory services and some institutional investors showed some leniency in connection with rights plan adoptions. Both ISS and Glass Lewis, which have historically disfavored rights plans, came out with guidance in early April stating that a severe stock price drop as a result of the COVID-19 pandemic is likely to be considered a valid justification for a rights plan of a term of a year or less.

You'll notice that most of the companies that did adopt rights plans are in industries that have been particularly hard hit by the pandemic. Like, the energy, retail, and travel industries, and also many companies that recently adopted rights plans have experienced particularly low total shareholder returns since earlier this year. I'd just note that since the market has rebounded, the rate of adoption of rights plans has slowed significantly. 46 companies adopted rights plans in March and April, and only 11 companies have adopted a rights plan since the beginning of May. So, this shows that, at least for now, many companies are feeling like things are a little bit back to normal and are not taking these measures like they were just a few months ago.

**Sam Gandhi:**

So, Beth, how are you advising clients with respect to poison pills?

**Beth Berg:**

Well, absent special circumstances, every public company should have a poison pill on the shelf. This means they prepared to adopt a rights plan quickly if desired, and one of the most important aspects of this is having a board record that supports the director's satisfaction of their duty of care. So, if you're on this podcast and you're a general counsel or you're on a board and you don't remember when the board has last received a shelf rights plan briefing or there's been significant board turnover since that time, I'd urge you to call us so we can make sure that you're prepared. At the end of the day, most boards do get comfortable having a rights plan on the shelf and not actually adopting the rights plan in the absence of a specific threat, even though it's impossible to track stock accumulations with precision, and SEC and HSR rules have enormous loopholes that result in companies having incomplete or delayed stock ownership information. So, it is possible to wake up one day with a surprise 13D filing or HSR notice, but there are some factors that would weigh in favor of adopting a rights plan sooner rather than later, and adopting a rights plan now rather than just having one on the shelf.

For example, if a company has significant net operating losses to protect, a rights plan could protect the company against an ownership change that under the tax laws could adversely affect the company's ability to use its NOLs. Also, if the company already has been approached by a hostile bidder or a known activist who owns stock, there is a greater risk of attack, particularly if the insertion's cash position remains strong today. A company that's in an industry that's been hit particularly hard by the pandemic and will remain so for the foreseeable future would also be more vulnerable to attack, and other factors could play into vulnerability, such as relatively low TSR vis-a-vis peers, high trading volume, low market cap, and significant trade flow.

I'd just add that although not a reason to adopt a rights plan because it's kind of like the tail wagging the dog, it is important to note that a board's decision to adopt a rights plan on a clear day and not in response to a specific threat harkens back to the days when nearly all public companies had tenure rights plans in place, and at least in Delaware, the board's decision to adopt a rights plan under these circumstances will have received business judgement rule deference. By contrast, if the adoption is in response to a specific threat, it'll be subject to enhanced scrutiny.

**Sam Gandhi:**

We saw the market go down and now we saw the market go up, and many people think that the market is going to potentially go down over the long run. So, do you think that because companies may start becoming a little bit more affordable again when those P/E ratios go down that we'll see the advent of hostile takeovers because of COVID?

**Beth Berg:**

Well, yes. If stock prices do go down and they stay down for a significant time period, I would expect hostile activity to rise. If you'd asked me are we going to see a lot more

hostile activity in 2020 back in March, I would have said definitely, but now that the market has rebounded we're just not seeing the types of opportunities for bidders to come in and try to scoop up companies that are undervalued. So, it's really a function of stock prices and also volatility to a certain extent because it's very hard for a hostile bidder to convince shareholders to tender when the price that is being offered is significantly lower than 52-week HV. So, as long as we're pretty close to the types of highs that we're seeing now and that we saw in the early part of this year, that should chill hostile activity, at least for the time being.

**Sam Gandhi:**

So, Kai, I'm going to bring you back to kind of where we started, which is that activists because of the crisis and the timing of the crisis have been relatively quieter than we've seen in past years, but I don't think any of those activists have really gone away, and when do you think they're going to start campaigning again?

**Kai Liekefett:**

Our expectation is that we will see a high number of campaigns starting this fall and winter and certainly at the very latest during the 2021 proxy season, and the reason why we come to this expectation is that we look at history. When you look at what happened after the 2008 financial crisis, the numbers are actually pretty remarkable. So, the average number of proxy contests per year in the five years leading up to the 2008 financial crisis was 86. In the last 10 years, the average number of proxy fights per year in the United States was 93. In 2009, the year after the financial crisis, we had 133 proxy fights.

So, we fully expect a high number of proxy fights, and the expectation right now is that a lot of activists will not wait until the 2021 proxy season. A lot of activists will see whether they can go after their target companies earlier than that using special meetings or consent solicitations to remove or at least threaten to remove boards off-cycle, and needless to say, if you are one of the few companies who have an odd fiscal year and you regularly hold your annual meeting in the fall, you're even more vulnerable than a company that is only exposed to a risk of a special meeting or a consent solicitation proxy fight in the fall.

A lot of activists have been out and about and raised capital. For instance, Pershing Square announced publicly that they raised one billion dollars for a special purpose vehicle, or SPAC, to use for campaigns. We know also for a fact that Elliott's, Engaged Capital, and others were out raising capital. So, we would expect to see a rise of campaigns as early as this fall once it becomes socially acceptable to run more campaigns again.

**Sam Gandhi:**

When you talk to a board, the CEO, or a general counsel and you give them these warnings about how to prepare for the expected return of activism and potentially hostile takeover bids, what do you tell them to do?



**Kai Liekefett:**

Well, we have a short list of immediate action items, and action item number one is you ought to assemble your response team right now, and that is not more than just a page with the phone numbers and email addresses of the defense team that you would need in the event you get attacked out of the blue. There needs to be an investment banker with significant activism experience, proxy fight counsel. You need a proxy solicitor and a specialized PR firm. So, you need to have that core team. That's step number one.

Step number two, you need a communications plan, what we call a break the glass plan. There is oftentimes not a lot of early warning before an activist issues a nasty public letter, and therefore you need to be prepared with draft press releases and media statements, shelf press releases if you will, to respond in the same news cycle in the event that an activist comes after you out of the blue. You ought to have stock surveillance. You need to make sure that you monitor the trading in your stock to make sure that you receive advanced notice in the event an activist is quietly building a stake. You ought to focus on your investor relations. You need to make sure that your investor relations department is screening meetings and calls for activists and need to listen for new questions about strategic issues that may come more and more.

Oftentimes activists are trying to pressure test some of the investment seizures by talking to investors, and sometimes these kinds of ideas are filtering back through these investors to the company if an investor relations officer knows how to listen for these kinds of new concepts, and then on the legal front, you need to make sure that you review your legal defenses for proxy fight counsel. You ought to review your charter and bylaws for legal strengths and weaknesses in the proxy fight contest. You also need to make sure you have a fully drafted and negotiated poison pill on the shelf so that you can adopt one quickly in the event an activist attacks if that situation is warranted, and lastly, you need to go through your corporate governance. You need to analyze your company's corporate governance purely from an activism campaign standpoint. You need to understand what are the kinds of issues that activists like to capitalize on in campaigns.

For instance, in addition to the board tenure that I spoke of earlier, what activists love to focus on is how much did the board go out of pocket to buy shares in the company as distinguished from acquiring shares in the company by way of stock grant? They take that as a sign of how committed a director is to the company. And one last insider trick that I want to share is that a lot of activists are approaching in the ramp up phase, quietly behind the scenes, current or former executives and employees and offering them oftentimes money to share confidential information including dirt about the company. So, what you need to be very focused on to address that issue is that you negotiate very, very tight severance agreements with executives who are leaving the company. Just make sure that they have a really airtight nondisclosure clause, a very, very tight confidentiality obligation that lasts for a long time, and you should also include

language that prevents the former employee or executive from participating in a proxy contest. We have seen this more and more in the last couple of years.

**Sam Gandhi:**

Do you think the remote environment that people are in makes it harder or easier for an activist to try to get more information from people?

**Kai Liekefett:**

That's a great question. Very interested also what Beth thinks. I mean, two factors. Number one, it is more difficult to bump "accidentally" into potential sources of information. So, what activists in the pre-COVID-19 times used to do is they tried to sneak up on board members and executives and employees at cocktail receptions and other private social gatherings and get them to talk. So, that, I think, has become more difficult for activists.

Campaigning, however, has become significantly easier and cheaper for activists. So, in the good old days, I mean, in order to run a proxy fight, you had to go and see at least 20 different institutional investors and you typically did this in person, and a lot of them are in New York. A lot of them are also in Boston and Pennsylvania. Dimensional is in Austin. Others are in the Midwest. Some on the west coast. So, it really required significant planning and logistical effort to run a campaign, not to mention the meetings with ISS in Maryland and Glass Lewis in San Francisco. So, that has become significantly cheaper and easier for activists.

**Beth Berg:**

I would agree with all of that, and I would just add that the type of diligence that activists typically do before investing in a stock is very similar to M&A diligence, and so it can be more difficult to do boots on the ground type diligence, walk facilities, count cars in parking lots, you know, do that kind of thing. It doesn't mean they can't do any, it just means certain types of diligence are more difficult to do in these times than they've historically been able to do them.

**Sam Gandhi:**

We've been speaking with Sidley partners Beth Berg and Kai Liekefett about the impact of COVID-19 on shareholder activism and how companies can best prepare. Beth, Kai, these are really unusual times for businesses and their boards who are contending with not just shareholder activism, but their reactions to the COVID crisis, and thanks for coming on the podcast and sharing your insights.

**Beth Berg:**

My pleasure.

**Kai Liekefett:**

Thanks for having us.

**Sam Gandhi:**

Before we wrap up, a word about Sidley insights, the content section of our website. We've set up a special page with the COVID-19 Resource Center. You can read articles related to various legal issues impacted by the coronavirus crisis, including the effects on mergers and acquisitions, securities disclosure, environmental law, and contract disputes, and we're going to be posting more in the coming days and we're planning future podcasts, too. You can find our COVID-19 Resource Center by going to [Sidley.com](https://www.sidley.com). You've been listening to the Sidley Podcast. I'm Sam Gandhi. Our executive producer is John Metaxas. You can hear more episodes at [Sidley.com/SidleyPodcast](https://www.sidley.com/SidleyPodcast) or subscribe on Apple Podcasts or wherever you get your podcasts.

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