

The Board as Activist

Directors must understand the vulnerabilities of their companies in four key areas.

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The universal proxy rules, which went into effect on September 1, 2022, have shifted the landscape of shareholder activism by allowing shareholders to “mix and match” their votes across proxy cards in contested elections. Since September, the move to candidate-based (rather than slate-based) voting has encouraged activists to nominate smaller, more targeted slates, and the added leverage in settlement negotiations has ultimately resulted in activists winning a larger number of board seats. In addition, mega-cap companies in the United States have been targeted more than ever before, despite a modest decline in total campaigns, with some companies becoming targets of the growing “swarming” phenomenon, whereby multiple activists target a vulnerable company concurrently or in rapid succession.

In response to the heightened threat posed by these changes, boards can benefit from stepping directly into the shoes of an activist, thinking critically and objectively about the vulnerabilities of their companies in key areas, and taking proactive steps to address such vulnerabilities.

Strategy

The best defense against shareholder activism is a clear and well-articulated strategy, and strong execution of such strategy, as evidenced by financial performance. As boards consider management’s proposals and help hone strategic and operational decisions, among other things, they should consider how such actions may be viewed through an activist lens.

The board should compare the company’s performance to that of its

peers and relevant indices (particularly with respect to total shareholder return, or TSR, and operational metrics) and identify where the company might fall short in the eyes of an activist. When assessing strategic decisions, the board should take a critical approach and test management’s underlying assumptions. Given the trend toward ESG-related activism, including activism campaigns touting ESG concerns as an add-on to their main thesis, the board should also ensure that the company genuinely incorporates ESG into its strategic initiatives and updates its public disclosures to reflect such initiatives.

Corporate Governance

Corporate governance should be a key focus of the board’s analysis of the company. Activists always exploit a company’s governance vulnerabilities as part of



their broader activism campaigns. Therefore, it is important to regularly review the company's organizational documents to ensure that they reflect up-to-date best practices and are well-tailored to the company's specific circumstances. As an example, companies should confirm that the advance notice section of their bylaws is appropriately updated in light of the new universal proxy rules.

Activists will also target boards that are not well-refreshed and, in particular, directors whose skills, experiences, tenure and background do not align with the activist's view of what the boardroom needs. The board should objectively assess its own structure and composition through the lens of an activist to ensure that they reflect the changing needs of the company, as well as a diversity of genders, ethnicities and ages. When vulnerabilities or gaps in the boardroom become evident, it is critical that the board make the tough decisions necessary for proper refreshment, rather than defaulting to the renomination of existing directors.

Shareholder Engagement

Effective relationship building with a company's shareholders is often the greatest tool in the activist's toolbox. Therefore, the board should work with its internal investor relations team and advisors to create a robust shareholder engagement program that lays the groundwork for an open and candid relationship with shareholders in the event of a proxy contest. Research demonstrates that shareholder engagement is associated with increased shareholder confidence in management and the board, as well as a lower likelihood of activism (and that when companies do experience

activism, those with greater engagement have less costly campaigns).

As part of its shareholder engagement program, the company should get to know its broad base of investors, including what motivates them, what concerns them and what excites them. The shareholder base is not monolithic — all investors do not necessarily value the same things. When engaging with investors, the company should understand and be proactive about any feedback it receives and address any misconceptions that investors may have.

In addition to shareholder engagement, the company should work toward cultivating strong relationships with other third-party constituents, such as analysts, proxy advisory firms and the media, who can also play an important role in a future proxy contest.

Contingency Planning

Even for companies that are not currently under an activist attack, it is beneficial to be thoughtful about contingency planning, so that the board and management team know exactly how to proceed and can respond quickly if an activist does emerge.

An effective contingency plan would include putting an early warning system in place for the arrival of an activist and retaining a team of advisors, including legal counsel, an investment bank, a PR firm and a proxy solicitor, which are prepared to guide the company in the event of an activism campaign. The company should also put in place a "break the glass" response plan for the most likely contingencies, particularly in the case of an "ambush" public attack without prior warning from the activist, and conduct

annual tabletop exercises as a board to simulate various activism scenarios.

Finally, the company should consider the placement of a shareholder rights plan on the shelf in case an activist begins to rapidly accumulate a stake in the company.

By planning in advance for the potential arrival of an activist, the board can help to minimize the chance of activism and, should it occur, place the company on an even footing with the activist.

While there is no panacea for the risk that shareholder activism poses to public companies, boards can put their companies in a strong position to anticipate and tackle potential activism attacks by thinking like an activist and taking proactive steps to identify and address vulnerabilities. Ultimately, boards must apply their own business judgment in making decisions in the best interests of the company's shareholders, but the discipline of considering the company's actions through the perspective of an activist is a useful and instructive exercise in self-reflection. ■

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