Insights
June 2023

Skadden

Changes in the Market and the Emergence of New Players Together Are Impacting Activism

This article was published in the June 2023 issue of *Insights*.

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Demetrius A. Warrick
Partner / New York
212.735.3235
demetrius.warrick@skadden.com

Richard J. Grossman
Partner / New York
212.735.2116
richard.grossman@skadden.com

Neil P. Stronski
Partner / New York
212.735.2839
neil.stronski@skadden.com

Alexander J. Vargas
Associate / Chicago
212.735.3302
alexander.vargas@skadden.com

Key Points

- The ultimate impact of the SEC's new universal proxy rules is not yet clear, but they could make some individual directors more vulnerable to activist challenges.
- Despite the drop-off in M&A activity, the share of activist campaigns urging some kind of strategic transaction has remained at roughly historical levels, with a refocusing on corporations' capital allocation practices.
- Activists seemingly are more interested in keeping engagement with companies private, often reaching agreements in response to private demands without a public fight.
- As always, companies should have strategies in place to address activist pressure before it arises, including ongoing stockholder communications programs and monitoring systems to detect activist trading.

Despite a slowdown in M&A activity and macroeconomic headwinds, stockholder activism remains a potentially powerful tool for investors aiming to extract value from companies. The activism landscape continues to evolve as new players enter the fray, activist campaigns and tactics are tailored to market conditions and the impact of the universal proxy card becomes clearer.

Universal Proxy Rules and Increased Focus on Individual Directors

New Securities and Exchange Commission (SEC) rules became effective for stockholder meetings after August 31, 2022, requiring that all board nominees — both the company's and an activist stockholder's — be included on each of the respective proxy cards in a contested election. These "universal proxy rules" enable stockholders to mix and match any combination of a company's and activist's nominees they wish to vote for in a proxy fight.

Changes in the Market and the Emergence of New Players Together Are Impacting Activism

Though it is too early to fully determine the impact of the universal proxy card, the results so far of contested elections under the new regime indicate that there will be enhanced scrutiny by investors and proxy advisers on the qualifications of the nominees' profiles, capabilities and past performance as a director or executive.

Practice point: Going forward, in preparing for a potential contested election, companies should consider the increased need to clearly communicate their rationale and strategy for board refreshment and composition as a whole. They should also pay particular attention to individual directors who may be vulnerable to an activist attack due to, among other reasons, long tenure, sitting on too many boards, a lack of relevant expertise or skill sets, or redundancy of their expertise in the boardroom.

(See also "Shareholder Proposal No-Action Requests in the 2023 Proxy Season: Companies Continue To Face a Challenging Environment.")

New Players

While traditional activists such as Elliott Management, Starboard Value and Carl Icahn continue to pursue activist campaigns regularly, new activist funds are also launching campaigns and looking to make a name for themselves among the investor community. We have seen new funds such as Irenic Capital Management and Politan Capital Management, led by experienced activism practitioners who previously worked at established funds, commence campaigns at companies including News Corp and Centene Corporation, respectively.

Additionally, we have seen an uptick in activist attacks from individual stockholders and first-time or occasional activists, such as the campaigns of Ryan Cohen against Nordstrom, Inc. and Ken Lui against HSBC Holdings. We have also seen activist-style attacks from former and current directors and/or members of management. For example, stockholders and former directors of Cano Health launched a withhold campaign at the company. These two trends indicate that the ability to accumulate a stake in a company and launch a campaign is not limited to traditional activist funds.

Practice point: The growing community of potential activists makes it even more crucial for companies to establish and maintain a clear line of communication with their investors and monitor their investor profile and stock trading behavior. Companies should invest in a robust stockholder communication practice that regularly engages with investors and clearly lays out the company's strategic plan. Further, companies should put in place a stock watch program to track unusual trading activity and stock accumulation (including through derivatives), and monitor traditional and nontraditional channels to better understand investor sentiment.

Shift in Activist Objectives

Historically, M&A has been a key component of the playbook for activists, who often agitate for management teams and boards to seek a strategic transaction as a means to achieve a significant return in a relatively short period of time. Despite the slowdown in global M&A activity, the portion of activism campaigns in Q1 of 2023 with an M&A-related thesis remained in line with historical averages. However, a larger portion of such campaigns were focused on breakup transactions or divestitures of specific lines of business, or on activism to scuttle or sweeten previously announced transactions.

Activists are also focusing more attention on capital allocation practices, urging companies to take actions such as returning capital to stockholders and scrutinizing a company's use of capital (*e.g.*, criticism of prior M&A transactions).

Practice point: As a general matter, at regular intervals companies should review their short- and long-term strategic plans to ensure they align with the interests of all stockholders. This includes determining whether there are opportunities to engage in strategic transactions that will maximize value. Further, regular consideration should be given to capital allocation practices and whether there are options to deliver value to stockholders through a return of capital.

Private Engagement and Settlement

Increasingly, activists are opting to engage privately with companies, often seeking to settle their demands through a negotiated agreement. In many instances, settlements are occurring before a public campaign is announced, which means parties can avoid a time-consuming, distracting and costly public contest. This trend is likely due to various factors, including the implementation of the universal proxy card, activists' taking a more "constructive" approach to engaging with companies, the improved quality of activist nominees for election or all of the above.

In addition, some companies have implemented actions proposed or recommended by activists without a formal agreement, and those actions are often followed by a public statement of support from the activist. Note, however, that without a formal agreement, companies do not obtain the benefit of customary standstill protections and voting agreements.

When approached by an activist, companies are almost always engaging privately with them to better understand their thesis and/or demands. Though current investor expectations support direct engagement, the board will in each case determine whether it is appropriate to take actions recommended by the activist or to continue to pursue the company's strategic plan.

Changes in the Market and the Emergence of New Players Together Are Impacting Activism

Preparedness Is Key

Though the activism landscape continues to develop, advanced preparation remains the best course to prevent and defend against an activist approach.

- **Establish a core response team:** A team composed of members of the board, key members of management and the company's outside advisers should be formed ahead of any activist approach. The team will develop a communications plan under various activism scenarios and help fine-tune the investor relations messaging and stockholder engagement.
- **Be your own activist:** Review the company's short- and long-term strategic plans and conduct a vulnerability assessment. Based on those measures, consider whether the company should take action to align the plan with the best interest of stockholders.
- **Develop and execute a plan for stockholder outreach:** Regularly engage with the company's stockholder base, including index funds, and monitor investor forums to better understand investor sentiment.
- **Maintain a stock watch program:** Although it is more of an art than a science, maintaining a proactive stock watch program can detect activists' accumulation of shares (or derivatives) prior to the lodging of any demands.
- **Review board composition:** Assess the makeup of the board and its refreshment processes to ensure that the company has the right directors to fulfill the board's duties to the company and its stockholders, with a specific focus on any individual director who may be vulnerable to an activist challenge.

One Manhattan West / New York, NY / 10001 / 212.735.3000