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The Year in Review: The Maturing of the U.S. Market for Shareholder Activism

Shareholder activism has evolved to be a prominent, and almost certainly permanent, feature of the corporate landscape. At the same time, the "success" of activists has been overstated – both in terms of board seats won at target companies (most of which have been gained by a handful of key activists and in a limited number of campaigns) and in terms of overall investment returns (which, but for a small number of activists, have been both volatile and lackluster). Notably, at the start of 2019, activism in the U.S. already exhibited the hallmarks of a mature market; there was a dearth of potential targets untouched by prior experience of activism; a handful of activists in campaigns at companies of scale dominated the space; and, in an effort to avoid activism, boards were increasingly focused on proactively addressing potential catalysts.

As we approach the end of 2019, the maturity of the activism market in the U.S. is reflected not only in overall activity levels, which are essentially unchanged relative to a year ago, but also in the infrequency of protracted public campaigns. New themes – including more aggressive tactics by activists, heightened scrutiny of workplace conduct and changing market conditions – may create opportunities for activists going forward; but potential challenges for activists abound, particularly in the event of a market downturn.

Noteworthy Activist Campaigns and Trends in 2019

Activism has been steadily trending away from contentious public fights and, as a result, there were few protracted adversarial contests this year. This dynamic is encapsulated by the recent campaign by Elliott Management at AT&T. Just a few weeks after Elliott publicly disclosed its "Activating AT&T Plan," AT&T announced a three-year financial and capital allocation plan and portfolio review, added two new directors and commented on its "constructive" discussions with Elliott. Elliott, in turn, issued its own statement of support for AT&T. Such a sequence of events at an iconic, mega-cap American company would have been almost unimaginable just a few years ago. That these events transpired at a Fortune 10 company in the course of a few weeks says as much about the advance preparedness of sophisticated issuers and boards today as it does about the influence of prominent activists like Elliott.

Other noteworthy situations this year underscore the following important trends: the growing use, and acceptance, of campaigns in which the dissident nominates a control slate of directors; the tendency toward *recurrent* activism at companies of scale; the proliferation of situations involving multiple activists; the continued dominance of a small number of well-known activists in leading campaigns at large companies; the growing willingness of issuers to work collaboratively with activist investors; the global nature of activism and prominence of U.S. investors in non-U.S. campaigns; and the increased frequency of campaigns in opposition to, or catalyzed by, M&A transactions.

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Notable 2019 campaigns reflecting these themes included the following:

- An investor group sought control of Bed Bath & Beyond's board, which led to a reconstituted board and the appointment of a new CEO.
- eBay, just a few years removed from Carl Icahn's campaign for the spinoff of PayPal, agreed in a settlement with Elliott to conduct a strategic review of its portfolio and to add Jesse Cohn of Elliott and another director to its board. At the time of the settlement, Starboard Value had also taken a substantial position in eBay.
- Papa John's turned to Starboard to serve as a stabilizing force following the company's ouster of founder John Schnatter. Papa John's issued convertible preferred equity to Starboard, expanded its board from six members to nine and appointed Jeffrey Smith of Starboard as Chairman.
- Carl Icahn continued his ongoing campaign for change at Occidental Petroleum following its acquisition of Anadarko, renewed agitation at Conduent (formerly the Business Process Outsourcing business of Xerox) and recently called for a merger of HP and Xerox.
- Third Point took a $1.5 billion position in Sony and, for the second time in six years, proposed a breakup of the company.
- Starboard conducted an unsuccessful campaign in opposition to the Bristol-Myers/Celgene merger. Wellington Management, one of Bristol-Myers' largest shareholders, issued a (for Wellington) unprecedented public announcement of opposition to the merger.

Much has been made of the occasional forays of active institutional money managers (such as Wellington at Bristol-Myers) into public dissent or proxy activity. We believe it is unlikely that these activities herald a substantial shift toward public activist behavior by active managers. In our view, this type of behavior likely will remain only sporadic. Under the federal proxy rules, investors are permitted to publicize their views without filing a proxy statement and we note that, in the two decades that this has been permissible, investors have rarely availed themselves of this right. Factors that militate against a significant shift by active managers include: compliance considerations (including implications of switching from a Schedule 13G to a Schedule 13D, Section 16 issues and other potential trading concerns); limitations on active managers' ability to charge proxy expenses to their clients; the ability to engage privately with issuers; and potential adverse impacts on business relationships with issuers, who are potential clients for investment managers.

Legal Developments

Two legal developments this year are notable in the activism context. The first is the successful use of a universal proxy card by the Rice brothers in their proxy contest at EQT, which culminated in the dissidents winning a majority of seats on the EQT board. EQT bowed to pressure from the dissidents and agreed to permit their use of a universal proxy card that listed both the Rice nominees and the EQT nominees, giving shareholders the opportunity to choose nominees from either or both of the competing slates. The dissidents had filed suit in Pennsylvania claiming that EQT's nomination bylaw, which purported to give EQT the right to include Rice nominees on EQT's proxy card without offering Rice the same prerogative to include the EQT nominees on its proxy card, would mislead shareholders by creating the misimpression that the Rice nominees supported EQT's nominees. In light of the EQT experience, activists may be emboldened to press for the use of universal proxy cards in future contests and issuers are reassessing their nomination bylaws.

The second development affects proxy advisory firms such as ISS and Glass Lewis. In August, the SEC published an interpretive release regarding the applicability of the proxy rules to proxy voting advice. The release affirmed the SEC's position that proxy voting advice provided by a proxy advisory firm generally constitutes a "solicitation" subject to the federal proxy rules. In addition to potentially subjecting proxy advisory firms to disclosure and filing requirements, under this interpretation proxy advisor recommendations give rise to potential liability under Rule 14d-9, meaning that aggrieved issuers and dissidents could potentially sue the proxy advisor. In November, the SEC announced proposed amendments to the proxy rules to codify the views expressed in the August interpretive release. Under the proposed amendments, an exemption from the proxy information and filing requirements would only be available if the proxy advisor complies with certain disclosure and procedural requirements. Regardless of the availability of an exemption, proxy adviser communications would be subject to Rule 14d-9. ISS has sued, challenging the SEC's authority to adopt the proposed rules.

Activism Outlook for 2020

We expect that the first part of 2020 is likely to be business as usual, as investments already made and those to be made in early 2020 will drive activism through the annual meeting season. Thereafter, the significant political uncertainty generated by a U.S. Presidential election – which already is being described as perhaps the most consequential in our history – is likely to cause a downturn in both M&A and activism activity, at least until after the election. Further, regardless of the outcome of the election, the long-running bull market, which has driven an M&A boom and helped to insulate activists (who are typically long-only holders, often with illiquid positions) against downside risk, must eventually come to an end. A major correction, with tightened credit markets, would present serious challenges to many activists and likely would lead to a significant reshaping of the activist landscape. Finally, it remains to be seen whether the current debate within the broader corporate community on the social "purpose of a corporation," with its emphasis on non-shareholder stakeholders' interests, will in any way change the activism playbook going forward.

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