

# Review and Analysis of 2018 U.S. Shareholder Activism

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**5% increase in total number of publicly announced campaigns against U.S. issuers**

**Elliott, Starboard and Spruce Point lead the way with the most publicly announced campaigns against U.S. issuers**

**Infrequent activists bring 68% of all publicly announced campaigns, up from 56%**

**56% increase in board seats obtained per announced 2018 campaign, as activists on average obtained 0.8 board seats per campaign**

**Issuers with market capitalizations between \$1 – \$10 billion targeted in 40% of announced 2018 campaigns despite comprising only 21% of Russell 3000 companies**

**37% of activist campaigns focus on M&A objectives, up from 26%**

**Proxy contests focusing on board-related governance matters decrease significantly from 51% to 14%**

**Proportion of publicly filed settlement agreements expressly permitting information sharing with the activist fund drops from 18% to 7%**

## Introduction

On the surface, the 2018 activism data is largely consistent with 2017, but with an uptick in overall activity. The amount of capital invested in new activist positions in 2018 was up approximately \$2.5 billion from 2017,<sup>1</sup> and activists won more board seats in 2018 than in 2017, mostly through settlements. Although several well-known activists (including Third Point, Pershing Square and Greenlight Capital) announced disappointing investment results in 2018, and the industry experienced negative net asset flows overall, activist funds continue to attract substantial new capital.

While Elliott was the most active fund globally in 2018, accounting for 9% of all campaigns, many other established activists were busy: nine of the top ten activist funds (calculated by aggregate market value of their activist positions at year-end 2018) each invested more than \$1 billion in new campaigns in 2018.<sup>2</sup> 52% of all board seats won globally since 2013 have been won by a group of 11 activists (in order of board seats won): Starboard, Elliott, Icahn, JANA, Engaged Capital, Sarissa Capital, ValueAct, Corvex, FrontFour, Glenview and Legion Partners.<sup>3</sup> Many of these “name brand” activists have since spun-off new funds, or their key players have moved on to other funds, leading to a dispersion of skills and techniques across a wide playing field and resulting in 2018 producing a record number of first-time activists initiating campaigns.

Some activists are also doubling down on their strategies. For example, JANA recently announced it is closing its long/short equity funds to focus on activism and impact investing.<sup>4</sup> Additionally, if there were a market downturn in 2019, the lower entry point for activists would make investments more affordable in companies perceived to be undervalued. In the last four years, when the S&P 500 has decreased year-over-year and the median VIX has increased year-over-year (2014 to 2015 and 2017 to 2018), we have observed increases in the total number of publicly announced activist campaigns. Conversely, during the same four-year period, we have observed decreases in public activist activity in those years in which the S&P 500 has increased year-over-year and the median VIX has decreased year-over-year.<sup>5</sup>

The consistency of 2018’s data with 2017’s data across multiple metrics suggests that activism practices have begun to stabilize. However, the data alone does not tell the full story, as there have been a few notable trends emerging in the past year. These include: (1) the rise of “purpose” investing; (2) rising prospects for increased civility in activist contests; (3) the changing regulatory landscape; (4) developing technologies that are altering the ways activists and issuers alike can reach shareholders; (5) increased focus on M&A objectives in activism campaigns, including post-deal announcement; and (6) a heightened focus on CEO succession. In addition, more companies are prepared for activists, and activists’ strategies are less likely to seem novel or catch large issuers by surprise. Further, more advisors have entered the activism space, resulting in a proliferation of information about how to engage with activists and other shareholders.

1 Based on aggregate value of new activist positions calculated as of campaign announcement date and not inclusive of derivative positions. See Lazard’s Shareholder Advisory Group, 2018 Review of Shareholder Activism.

2 See Lazard’s Shareholder Advisory Group, *2018 Review of Shareholder Activism*.

3 See *id.*

4 See Wall Street Journal, *Jana Is Closing Two Hedge Funds That Lost Money in 2018* (Jan. 15, 2019).

5 Based on information from SharkRepellent.net for U.S. companies with market cap over \$100 million. See “Notes on the Scope and Sources of Data Used in This Publication” on page 4.



## NOTES ON THE SCOPE AND SOURCES OF DATA USED IN THIS PUBLICATION

The information in this publication on proxy contests and other activist campaigns is based on the database maintained by FactSet Research Systems, Inc. on SharkRepellent.net, using a dataset run on January 15, 2019, supplemented by our review of public information and other third-party sources. To provide an analysis relevant to our U.S. public company clients, we have not included campaigns at companies with a market cap of under \$100 million and have not included campaigns at non-U.S. companies. We have followed the SharkRepellent categorization of campaigns as “proxy fights” or “other stockholder campaigns,” but have not included those categorized merely as exempt solicitations or Schedule 13D filings with no public activism. We have not included the mere submission of Rule 14a-8 proposals as “campaigns,” although the section “Types and Objectives of Activist Campaigns” discusses the use of shareholder proposals that were brought in conjunction with the activist campaigns covered in this publication. We have also excluded from the “other stockholder campaigns” category strategic acquisition attempts that involve unsolicited offers by one business entity to acquire another, though we have included takeover attempts involving unsolicited offers by activist hedge funds. In addition, where one activist launched campaigns against several affiliates we counted this as one campaign for purposes of comparison and analysis. Further, we have categorized activist campaigns based on the calendar year in which a campaign was launched, even if the campaign is completed (*e.g.*, an activist gains a board seat) during the following calendar year.

Data in this publication regarding hedge fund assets under management (AUM), performance and formation is based on the year-end 2018 Hedge Fund Industry Report issued by Hedge Fund Research (HFR) on January 18, 2019, unless otherwise indicated. Other data sources, including Proxy Pulse (a Broadridge and PricewaterhouseCoopers initiative), are identified as they arise.

Our analysis throughout this publication is heavily dependent upon this data, statistics, our anecdotal experience and various assumptions. If our assumptions prove to be incorrect or if the data is incomplete or contains errors, our analysis and conclusions could change. Moreover, every activism situation is unique and none of the statistics and analysis presented in this publication should be construed as legal advice with respect to any particular issuer, activist or set of facts and circumstances.

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## 1

## TRENDS IN SHAREHOLDER ACTIVISM

Broadly speaking, shareholder activism is the practice of purchasing an issuer's shares with the primary intention of influencing the corporate strategy or governance of the issuer. Our annual shareholder activism study does a deep dive into the data underlying U.S. activism activity to elucidate trends.

### A. INTEGRATING "PURPOSE" AND ACTIVISM

Index funds provide virtually permanent capital for corporations. For many years, issuers argued that activists engaged in "short-term" thinking, as reflected in proposed financial engineering strategies designed to shake loose a quick special dividend or share buyback. There was a time when the "long termism" of index funds was seen as a potential boon to companies defending against "short term" activists, and it is true that index funds, on the whole, have been less likely to support activists than other kinds of institutional investors.<sup>1</sup> However, index funds have not as consistently voted against activists as once hoped.<sup>2</sup>

In our most recent annual proxy season memo (available [here](#)), we noted the rise of environmental, social and political (ESP) related shareholder proposals and voting policies of proxy advisors and institutional investors. Investor focus on these issues persisted well after the culmination of the 2018 proxy season, with the governance "industry" adapting to this focus by promulgating "sustainability scorecards" and promoting "disclosure enhancements" to address human capital management, sustainability and other ESP-oriented topics. Recently, several of the largest institutional investors reaffirmed this trend with clear statements that they continue to be intensely focused on issuers' "purpose," how corporations treat their employees, communities and other stakeholders (not just shareholders), and similar concepts. In his annual letter to CEOs, for example, Larry Fink (CEO of BlackRock) described "purpose" as "a company's fundamental reason for being – what it does every day to create value for its stakeholders."<sup>3</sup>

1 See Alon Brav et al., *Picking Friends Before Picking (Proxy) Fights: How Mutual Fund Voting Shapes Proxy Contests* (Mar. 1, 2018) (finding that passive funds are more friendly towards management and less likely to vote in favor of dissidents/activists than other types of funds). The biggest institutional investor supporters of activists in proxy fights from 2013-2018 were T. Rowe Price, GS Asset Management and JP Morgan Investment Management.

2 See Moelis & Company, *Activist Shareholder Advisory Discussion Materials* (Jan. 2019) (finding that, since the beginning of 2011, each of the "Big 4" index funds has supported the dissident card in about one of every four proxy contests voted, with BlackRock leading the pack, voting for the dissident card 29% of the time).

3 See Larry Fink's 2019 Letter to CEOs – Purpose & Profit (available at <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>).



...notwithstanding institutional investors' calls for more gender diversity on boards, only 18% of activist appointees in 2018 were female, as compared to 40% of new S&P 500 directors in 2018.

This additional focus on “purpose” and stakeholders appears to be part of a larger sociopolitical trend that is reflected in a swell of populism, frustration with income inequality and faith lost in the social and environmental by-products of Adam Smith’s invisible hand. In the political forum, this trend has manifested in the form of legislative action (Senator Warren’s effort to federalize corporations, California’s quotas for female directors and Senator Sanders’ and Senator Schumer’s push to limit stock buybacks, for example). However, both State Street and BlackRock have stressed that their advocacy for a broader perspective on corporate value not be construed as their having a political or social agenda. Indeed, their approach contrasts sharply with some frequent shareholder proponents like the NCRPP, which has an overtly political/social agenda. Instead, both BlackRock and State Street have linked their purpose-driven agenda to a value proposition intended to satisfy their fiduciary duty to their own investors, not to mention ERISA’s fiduciary requirements.

Because winning the largest index funds over is crucial in any activism situation, given the explosive growth of these funds over the past few years (as discussed further in the section “Institutional Investors” below), one might expect to see activists trying to attract support from institutions with arguments about “stakeholders” and “purpose.” However, this behavior was *not* an observable trend in 2018: the year’s heightened focus on ESP and “purpose” often seemed like it was just background noise in activism campaigns. Specifically, notwithstanding institutional investors’ calls for more gender diversity on boards, only 18% of activist appointees in 2018 were female,<sup>4</sup> as compared to 40% of new S&P 500 directors in 2018.<sup>5</sup> We are not aware of an index fund failing to support an activist merely because the activist publicly presented an all-male slate.<sup>6</sup> An ISS study recently confirmed that, in the aggregate, activist appointees do not promote gender or racial/ethnic diversity, and activists’ slates in contested elections are dominated by investment professionals and a mix of former and sitting executives.<sup>7</sup> The largest index funds appear to have given the activists a pass on the lack of diversity in their slates.

However, it remains to be seen whether the focus on ESP and “purpose” will become more meaningful for activist funds in the coming years. Notably, two former investing partners at Blue Harbour Group recently launched Impactive Capital, an activist investment firm seeded by CalSTRS that will engage with companies over ways

<sup>4</sup> See Lazard’s Shareholder Advisory Group, *2018 Review of Shareholder Activism*.

<sup>5</sup> See Spencer Stuart, *2018 United States Spencer Stuart Board Index* (available at [https://www.spencerstuart.com/-/media/2018/october/ssbi\\_2018.pdf](https://www.spencerstuart.com/-/media/2018/october/ssbi_2018.pdf)).

<sup>6</sup> This may be exacerbated by the fact that very few women serve in senior roles at activist funds. As of February 2019, a mere 11.2% of senior positions at hedge fund managers were occupied by female employees. See Prequin, *Women in Hedge Funds* (Feb. 2019).

<sup>7</sup> See Institutional Shareholder Services, *The Impact of Shareholder Activism on Board Refreshment Trends at S&P 1500 Firms* (available at <https://www.issgovernance.com/library/the-impact-of-shareholder-activism-on-board-refreshment-trends-at-sp-1500-firms/>).



If civility of discourse in activism situations is in fact a growing trend, it should enhance management teams' ability to stay focused on their "day jobs" of running businesses without the distractions brought on by responding to a steady stream of attacks.

to improve capital allocation and ESP practices.<sup>8</sup> We may start to see more overt efforts by activists to challenge incumbent management teams and boards for neglecting to focus on long-term attributes of profitability, and seeking to position themselves as partners in institutional investors' efforts to bring more focus and accountability to identifying directors' skills and capabilities. We would not be surprised to see an activist attack a coal company or gun or opioid manufacturer for failing to have more socially responsible practices, or target a natural resources company for having ineffective risk management in relation to its environmental practices. We may also see activists focus on executive compensation not only as an avenue for righting perceived poor governance and mismanagement at target companies, but also for drawing focus to issues like human capital management and corporate culture—though this may be a more difficult avenue for activists than other ESP initiatives given the overwhelming support for say-on-pay votes at public companies.<sup>9</sup>

## B. RISING PROSPECTS FOR MORE CIVILITY IN ACTIVISM SITUATIONS

Aggressive activist attacks are legendary, from stories of activists going through a CEO's literal and figurative garbage to examples of directors being tailed by activists on social media and at cocktail parties.<sup>10</sup>

These extreme investigative tactics are presumed to be a stepping stone to a damning out-of-the-blue public letter that will disrupt the target's ownership profile by attracting arbitrageurs who are more likely to be seeking a short-term profit than long-term operational success. They also can create so much embarrassment for the CEO and directors that they concede and/or resign.

However, a recent article reviewed a more civil style of activist tactics as "soft" activism, emphasizing the importance of behind-the-scenes engagement.<sup>11</sup> Some activists are reportedly toning down their rhetoric and taking measures to soften their image (perhaps in a bid to appeal to the governance groups at the index funds).<sup>12</sup> If civility of discourse in activism situations is in fact a growing trend, it should enhance management teams' ability to stay focused on their "day jobs" of running businesses without the distractions brought on by responding to a steady stream of attacks. Civil discourse is also less likely to antagonize other stakeholders, such as labor unions or customers, who may become agitated by the hostility of the messaging

<sup>8</sup> See Wall Street Journal, *A Rarity on Wall Street: A Female- and Minority-Led Activist Hedge Fund* (Feb. 10, 2019).

<sup>9</sup> See Sullivan & Cromwell LLP, *2018 Proxy Season Review* (July 2018) (finding that support levels in say-on-pay votes exceeded 90% on average at public companies during the 2018 proxy season).

<sup>10</sup> See, e.g., Fortune, *Inside Elliott Management: How Paul Singer's Hedge Fund Always Wins* (Dec. 2017).

<sup>11</sup> See Harvard Law School Forum on Corporate Governance, Doron Levit, *Soft Shareholder Activism* (available at <https://corpgov.law.harvard.edu/2018/12/19/soft-shareholder-activism/>).

<sup>12</sup> See The Wall Street Journal, *Elliott Management Goes on Charm Offensive* (Oct. 8, 2018).

Directors should be updated periodically about activism and review their structural defenses to ensure they conform to best practices and provide the company with adequate time to respond to an activist attack.

and potential resulting vulnerability that can be a by-product of escalating PR battles in an activism contest.

Nonetheless, directors need to be resolute in their position and advised about the worst-case scenario. In this regard, directors should be updated periodically about activism and review their structural defenses to ensure they conform to best practices and provide the company with adequate time to respond to an activist attack. Companies also need to continue to be vigilant for short-sellers and “debt squeeze” tactics that can adversely impact public shareholders.<sup>13</sup> The success of Third Point’s campaign at Campbell (despite Campbell being approximately 41% owned by its founding family) is a good reminder that even with market-standard defenses and vigilance, no company should assume it is immune from activism.

### C. REGULATORY CONSTRAINTS ON ACTIVISTS

In the past few years, and especially in 2018, several governmental entities showed an appetite for enforcing their regulations against activists. Among other things, regulators have begun to focus on the following issues that may be relevant to activism contests:

1. **Director interlocks.** Where activists have designated directors on the boards of multiple companies in the same industry, they may run afoul of Section 8 of the Clayton Act (or in the case of banks, the Depository Institution Management Interlocks Act), which restricts interlocking directors on the boards of competitors. Notably, in January, ValueAct agreed to an information sharing arrangement with Citi rather than seeking a board seat, because the activist already had a board seat at one of Citi’s competitors, Alliance Data Systems, creating a perceived conflict.<sup>14</sup> This may be an issue even where the individual directors are different people if the activist is deemed to have “deputized” the individuals. In that case, those directors may be seen as a conduit for sharing competitively sensitive information among competitors. Note, however, that regulator-initiated action does not appear to have dictated any activist behavior in this area, as activists have generally tended to avoid this practice.
2. **Industry specific regulations.** Certain industries, especially banking, insurance and public utilities, may be subject to change

<sup>13</sup> Short sale strategies continued to be used by activists in 2018, including by Spruce Point in its approach of 2U, Inc. and Kynikos in its approach of Dunkin’ Brands. Activists also continued their historic use of “debt default activism”—a term used to describe the strategy whereby an activist purchases distressed debt and seeks to enforce a default. In 2018, Aurelius Capital Management used this tactic in its approach of Windstream Holdings, which ended in Windstream filing a voluntary petition under Chapter 11 to seek bankruptcy protection after it lost a lengthy court battle with the activist. Some have accused Neiman Marcus bondholders of using a similar strategy in recently agreeing to extend the term of the company’s outstanding bonds. See Bloomberg, *Neiman Marcus Struck ‘Devils Bargain’ With CDS Traders, Fund Says* (Mar. 4, 2019).

<sup>14</sup> See Bloomberg, *Citigroup Agrees to Give Activist ValueAct Details on Strategy* (Jan. 11, 2019).

Regulatory defenses are not a panacea for issuers seeking to fend off an activist attack, but recent enforcement actions have certainly put activists on notice that they ought to evaluate their regulatory profile before engaging in a campaign.

of control and other restrictions that could be implicated in activism contests. For example, Washington banking regulators stepped in when a shareholder activist, Roaring Blue Lion, initiated a proxy contest for HomeStreet, a Washington bank. The regulator issued an interpretive letter determining that there was a “substantial risk” that the company could not count votes on the activist’s proxy card, including for quorum purposes, because the proxies would essentially amount to a conveyance of controlling influence over a bank that had not been approved by the regulator. Activists preparing to approach a banking institution should also carefully consider the Depository Institution Management Interlocks Act, which generally prohibits management officials of a depository organization from serving in a management role at another depository organization where that service could have an anti-competitive effect.

3. **13D and HSR enforcement actions.** The SEC has reported enforcement actions relating to violations of Rule 13(d)’s beneficial ownership reporting requirements (both as to the timing of initial filings as well as to the obligation promptly to update existing filings to reflect a change in investment or voting intent).<sup>15</sup> Issuers have also, from time to time, requested that the SEC consider whether activists should be deemed to have formed a 13(d) group given the conscious parallelism of their behavior towards certain issuers that are the subject of side-by-side campaigns. The DOJ has also cracked down on activists failing to file HSR notifications in relation to acquisitions of common stock in excess of the reporting threshold, purportedly in reliance on the passive intent exception.<sup>16</sup>
4. **Common ownership.** Although not directed at activists, the Commissioners of both the FTC and the SEC have noted that the competitive effects of common ownership by institutional investors, especially index funds (the top-three of whom now collectively hold approximately 19% of the S&P 500)<sup>17</sup> deserve to be studied. This issue has become an area of focus due to assertions that having such large shareholders exerting common influence could dampen competition among public companies. A recent academic study, however, argued that this concern is misplaced on the basis that the funds are not actually exerting that kind of influence in practice.<sup>18</sup>

<sup>15</sup> See Harvard Law School Forum on Corporate Governance and Financial Regulation, *SEC Enforcement Actions for Failure to Update 13D Disclosures* (Apr. 5, 2015) (available at <https://corpgov.law.harvard.edu/2015/04/05/sec-enforcement-actions-for-failure-to-update-13d-disclosures/>).

<sup>16</sup> See Department of Justice, *Division Enforces the HSR Act in Cases Against ValueAct and Duke Energy* (available at <https://www.justice.gov/atr/division-operations/division-update-spring-2017/division-enforces-hsr-act-cases-against-valueact-and-duke-energy>).

<sup>17</sup> See Russell Reynolds Associates, *2019 Global & Regional Corporate Governance Trends* (Dec. 11, 2018).

<sup>18</sup> See, e.g., Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy* (Dec. 27, 2018).

The media strategies of the companies the activists target will need to evolve to keep pace with the activists—not just in the midst of a proxy contest but also as an important tool for good communication of key messages to investors in the off-season.

Regulatory defenses are not a panacea for issuers seeking to fend off an activist attack, but recent enforcement actions have certainly put activists on notice that they ought to evaluate their regulatory profile before engaging in a campaign.

#### **D. CUTTING EDGE SHAREHOLDER COMMUNICATIONS IN ACTIVISM CAMPAIGNS**

Special-purpose websites and alternative media were once the purview of mega-cap M&A transactions, but activists are increasingly using these techniques in their campaigns as well. 2018 saw a surge in the use of electronic media in proxy contests, such as activists posting YouTube videos and sending out flash drives filled with “pro-change” information to investors. For example, in the Third Point-Campbell Soup contest, Third Point posted a four-minute video to YouTube imploring shareholders to elect the activist’s board slate and #RefreshTheRecipe.<sup>19</sup> The use of these techniques is more common in relation to large-cap issuers, where the campaigns are higher profile and the activist often has to make a more sizeable investment to make its mark. This is especially true for those large companies that have a relatively high proportion of retail investors, whose historically low voting rates can be boosted by enhanced communication efforts. At this stage, these techniques are not widely used against small cap companies, even though they are the most frequent targets of activists. The dearth of flashy e-campaigns against small caps is probably attributable to the relative costs and benefits of “high production value” material in those campaigns. However, as activists develop new templates, the variable cost of employing these techniques in smaller campaigns will inevitably shrink and they will become more prevalent.

The media strategies of the companies the activists target will need to evolve to keep pace with the activists—not just in the midst of a proxy contest but also as an important tool for good communication of key messages to investors in the off-season. By way of example, some companies are discussing using pre-recorded videos (including “fireside chats” featuring their lead independent directors) to communicate the company’s long-term strategy, philosophies on board refreshment and other key messages. Companies are also increasingly considering how best to use social media to communicate with their investors. Of course, companies still need to be cognizant of and compliant with Regulation FD, non-GAAP disclosure requirements and other potential securities disclosure and liability rules in their communications.

In pursuing these communications alternatives, companies face the same cost-benefit analysis as activists: slick production targeting widely dispersed but sophisticated consumers of social media is more difficult to produce than simply issuing a press release. However, just as roadshows are a necessary element of *attracting* new capital in an

19 See <https://www.youtube.com/watch?v=DLptfL5jPDg>.



IPO, issuers increasingly view quality investor communications (not just media relations) as a key element of *retaining* investor support.

## E. M&A AS A CONSISTENT OUTPUT OF ACTIVISM

It has been clear for many years that activism catalyzes both friendly and unsolicited M&A because activists often drive efforts to put a company up for sale or engage in divestitures. Whether or not a company actually initiates a strategic review process (code for “sale or divestiture”) in response to an activist campaign, the attention generated by the activist may attract interest from unsolicited acquirors.

According to Lazard, 33% of 2018 activism campaigns were M&A-related. Of these: 41% pushed for the sale of the company; 28% pushed for a break-up or divestiture; and 30% sought to intervene in an announced deal, seeking a price bump or a termination of the deal. Examples of activists interfering in announced transactions in particular have surged, and include Carl Icahn’s opposition to the Cigna/Express Scripts and Dell/VMware transactions, and Krupa Global Investments’ opposition to Kraft Heinz participating in the auction for Campbell’s international business before there was even an announced deal on the table.

In a few high-profile incidents, the activists themselves have become the hostile acquirors, their campaigns turning into takeover bids by their own private equity affiliates. Notably, Elliott now has an active private equity arm that has engaged in some high-profile bidding, suggesting a convergence of activist hedge funds and traditional private equity.<sup>20</sup> In January, Elliott asked investors for \$2 billion to pursue take-private transactions.<sup>21</sup> Activists must carefully consider securities laws in the M&A context, particularly where the activist obtains material non-public information in the course of discussions with the issuer or where the activist teams up with a strategic acquiror (*e.g.*, Allergan-Valeant).

## F. SUCCESSION VACUUMS AS A LEADING INDICATOR OF ACTIVISM

A common theme in activist campaigns is an effort to oust a sitting CEO, such as Starboard Value’s and others’ campaign to push out the CEO of MGM Resorts. Less overt is activist involvement in companies that lack a permanent CEO, or that have an impending CEO retirement. Those cases may provide activists with the ability to have outsized influence in the selection of the next management team. It is unclear if activist involvement at this stage in a company’s life cycle actually makes it more difficult for a board to attract necessary talent (*i.e.*, are there potential CEO candidates who would turn down

<sup>20</sup> See Financial Times, *Elliott makes \$2bn bid for US oil producer QEP Resources* (Jan. 7, 2019).

<sup>21</sup> See Wall Street Journal, *Elliott Looks Beyond Activism to Full-Blown Takeovers* (Jan. 30, 2019).

**33%** of 2018 activism campaigns were M&A-related. Of these: 41% pushed for the sale of the company; 28% pushed for a break-up or divestiture; and 30% sought to intervene in an announced deal.

the role because an activist is present). What is clear *is* that any company expecting to undergo a CEO transition in the next couple of years would be wise to do some careful planning to ensure that the board's preferred candidate is identified well in advance of any public announcements, or significant speculation, regarding a transition, if possible, and investors have a clear picture of the board's focus and priorities with regard to succession planning. A company's public announcement of the CEO transition must be thoughtfully structured to instill investor confidence in the board's decision.

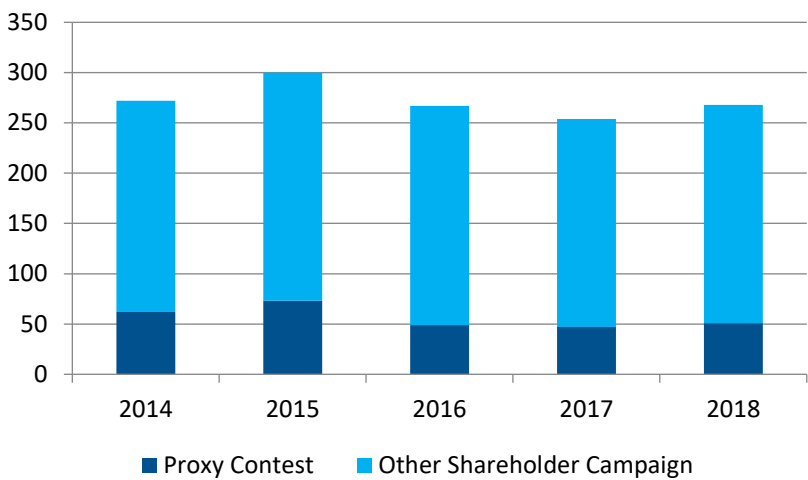
# 2

## ACTIVIST INVESTORS

### A. TOTAL ACTIVIST CAMPAIGNS

2018 saw a 5.5% increase in the number of activist campaigns, with 268 campaigns announced. The total number of campaigns has been remarkably consistent over the past five years with an average of approximately 272 campaigns announced per year. However, the total number of public campaigns in a given year does not paint a full picture; based on anecdotal information, a significant number of activist situations also are being resolved without publicity.

Activist Campaign Totals



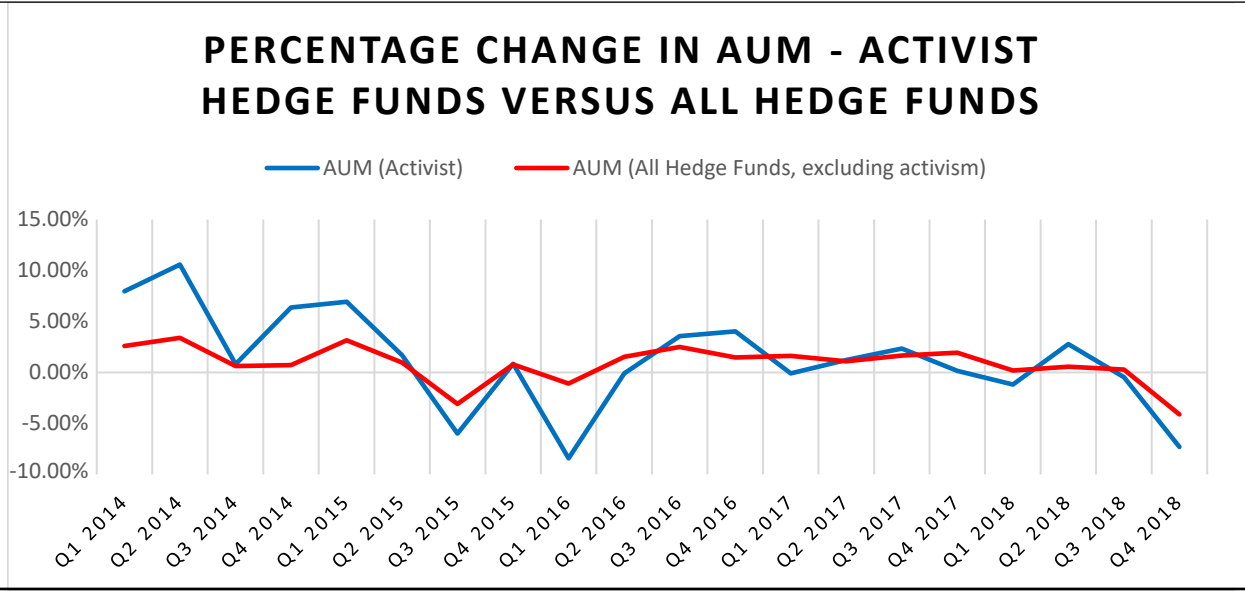
Proxy contests made up a slightly smaller percentage of announced activist campaigns in the past three years than had been observed in prior years. During these three years, less than 20% of activist campaigns developed into proxy contests. In comparison, full-scale proxy contests developed, on average, in slightly less than one-quarter of all activist campaigns announced in 2014 and 2015. Importantly, this statistic does not take into account campaigns that were settled prior to developing into a proxy contest but still resulted in board seats for the activists.

### B. ASSETS UNDER MANAGEMENT BY ACTIVIST HEDGE FUNDS

In 2018, activist hedge fund AUM showed modest decreases, shrinking at a meaningfully higher rate than hedge funds overall. The second half of 2018 was the first period since the first half of 2016 that activist hedge fund AUM declined, reversing a two-year period of continued growth. Note that the changes in AUM during the second half of 2018 may be largely attributable to overall market performance

and the differences in the portfolio composition of activist funds compared to non-activist funds. The decrease in non-activist hedge fund AUM tracked the Dow Jones Industrial Average (-3.84% and -3.89%, respectively) while the decrease in activist hedge fund AUM tracked the S&P 500 (-7.76% and -7.78%, respectively).

C. ACTIVIST HEDGE FUND WITHDRAWALS AND REDEMPTIONS



Activist hedge funds experienced negative net asset flows in each of the last three quarters of 2018, resulting in a total negative net asset flow of approximately \$2.18 billion in 2018. Despite a brief period of positive net asset flow from mid-2017 through the first quarter of 2018, the negative net asset flow in 2018 represented a shift back to the previous trend of negative net asset flows from the fourth quarter of 2015 until mid-2017. Net outflows at activist hedge funds represented approximately 2% of average AUM during this period, whereas outflows at all hedge funds represented just over 1% of average AUM.

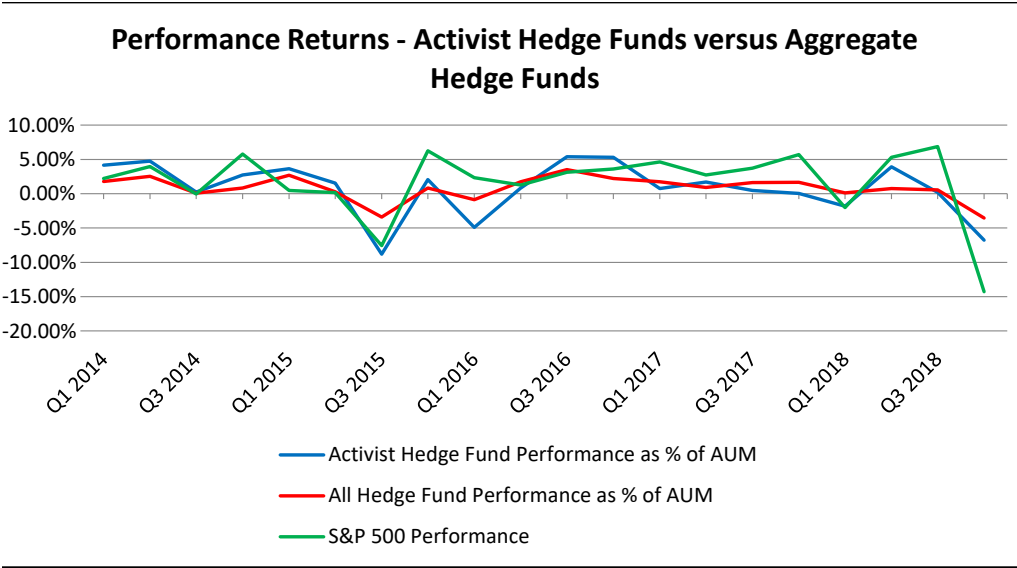
The disproportionate amounts of outflows from activist hedge funds over the last three years suggest, at a minimum, that these funds may face significant fundraising and fund-retention challenges when seeking to identify and capitalize on activism opportunities in the near-term.

D. ACTIVIST HEDGE FUND PERFORMANCE

In 2018, the hedge fund industry as a whole earned low returns—an average of negative 0.54% per quarter—and activists underperformed the hedge fund industry by posting average returns of negative 1.12% per quarter. In general, activist hedge funds have been more volatile than hedge funds overall, and this volatility has continued through recent years. Hedge funds significantly outperformed the S&P 500

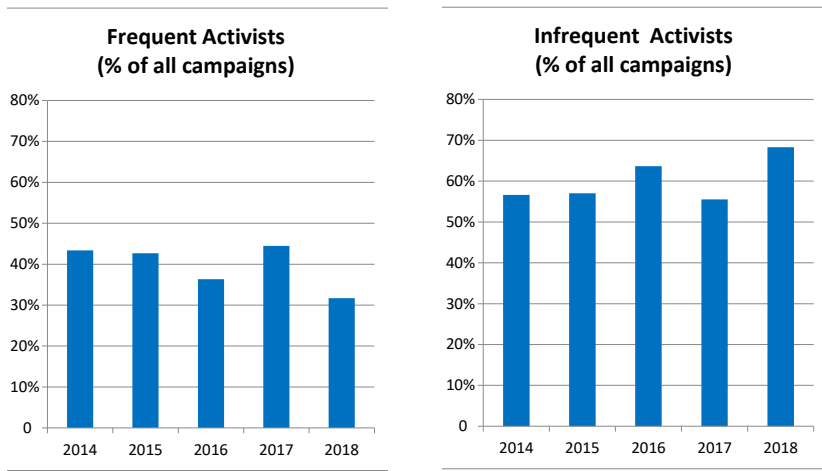


and the Dow Jones Industrial Average in 2018, which had returns of negative 6.2% and negative 5.6%, respectively.<sup>22</sup>



**E. INCREASE IN ACTIVIST CAMPAIGNS BROUGHT BY INFREQUENT ACTIVISTS**

Over the past several years, the percentage of campaigns launched by “infrequent” activist investors has increased and 2018 marked a continuation of this trend. For purposes of this publication, we have defined infrequent activists as firms that have brought five or fewer campaigns since the beginning of 2014. Infrequent activists brought 57% of all proxy contests and 68% of all publicly announced campaigns in 2018, marking an increase from 2017 when infrequent activists brought 54% of all proxy contests, but only 56% of all announced campaigns. The level of infrequent activist activity in 2018 was more consistent with 2016 levels.



<sup>22</sup> MarketWatch, *Here’s How Ugly 2018 Was For Stocks and Other Assets* (Jan. 1, 2019).

## F. FREQUENT ACTIVIST INVESTORS

The most frequent activists in terms of announced campaigns against U.S. issuers in 2018 were Spruce Point, Elliott Management and Starboard. In addition to the public campaigns discussed below, activists engage in “behind the scenes” campaigns that often prove successful. Elliott is the only activist to appear in the top-three of announced campaigns in each of the past four years. During this time period, Elliott has engaged in 34 announced campaigns against U.S. issuers. This is the first time Spruce Point, a long/short hedge fund founded in 2009 that focuses on short selling activism strategies, has appeared in the top-three over the past five years, but it was active last year as well, announcing seven campaigns in 2017. GAMCO, which had been in the top-three from 2014 through 2017, announced one campaign against a U.S. issuer in 2018:

### *Announced U.S. Campaigns by Most Frequent Activists*

<b>2018</b>	
Spruce Point Capital Management LLC	9
Elliott Management Corporation	8
Starboard Value LP	8
<b>2017</b>	
Elliott Management Corporation	10
GAMCO Asset Management, Inc.	9
City of London Investment Management Co. Ltd.	9
<b>2016</b>	
Elliott Management Corporation	8
Bulldog Investors, LLC	7
GAMCO Asset Management, Inc.	4
<b>2015</b>	
GAMCO Asset Management, Inc.	11
Bulldog Investors, LLC	9
Elliott Management Corporation	8
<b>2014</b>	
Starboard Value LP	10
GAMCO Asset Management, Inc.	9
Lone Star Value Management, LLC	8

## G. PROMINENT ACTIVIST INVESTORS

As discussed further in the section “Target Companies by Market Capitalization” below, a large percentage of Fortune 100 companies have been the targets of activist campaigns. But, given the capital required to acquire a significant stake in large-cap companies, only a small number of prominent activist investors have targeted Fortune 100 companies, and only five investors have announced more than two activist campaigns against a Fortune 100 target company since 2014.

### *Fortune 100 Campaigns 2014–18*

<i>Activist</i>	<i>Campaigns</i>
Triun Fund Management, L.P.	4
Third Point LLC	4
Icahn Associates Corp.	4
Value Act Capital Management LP	3
Greenlight Capital, Inc.	3
Elliott Management Corporation	2
Glenview Capital Management LLC	2
JANA Partners LLC	2
California State Teachers’ Retirement System	2
Arjuna Capital LLC	2

## H. MOST SUCCESSFUL ACTIVISTS BY BOARD SEATS OBTAINED

Activists have experienced higher success rates in obtaining board seats in recent years, although the volume of campaigns has declined markedly since 2015. In 2018, activists averaged 0.8 board seats per campaign, doubling the 2016 average. As summarized in the table below, activists on average have received more than one board seat for every two campaigns announced in a particular year.<sup>23</sup>

### *Board Seats Obtained by Activists at U.S. Issuers*

	<i>2014</i>	<i>2015</i>	<i>2016</i>	<i>2017</i>	<i>2018</i>
Total Board Seats Obtained	169	173	96	114	116
Number of Total Completed Campaigns	272	300	243	221	143
Average Board Seats Per Campaign	0.62	0.57	0.40	0.52	0.81

<sup>23</sup> For purposes of this section, board seats are recorded as obtained during the year in which the activist campaign was initiated.

The activists that have been the most successful at obtaining board seats are generally those who are the most prolific in terms of number of campaigns. Icahn Associates is a notable exception, in that it has not been in the top-three most frequent activists in any year during the past five years. However, in the campaigns it has announced, Icahn has been remarkably successful, obtaining, on average, 1.48 board seats in each announced campaign over the last five years. Many board seats are also obtained through “quiet” campaigns where an activist engages with the issuer “behind the scenes.” As noted in “Notes on the Scope and Sources of Data Used in This Publication,” this data is limited to U.S. companies, and so does not reflect the success of activist funds, like Elliott, in Europe over the past five years.

***Number of Board Seats Obtained by Most Successful Activists at U.S. Issuers***

	2014	2015	2016	2017	2018
Starboard Value LP	24	13	5	7	12
Icahn Associates Corporation	5	9	3	0	14
Elliott Management Corporation	7	6	9	6	5



# 3 TARGET COMPANIES

## A. TARGET COMPANIES BY MARKET CAPITALIZATION

Following a sharp increase in 2017 in the percentage of activist campaigns at the largest companies, 2018 saw a reversal of course with a decrease in the percentage of campaigns at the largest companies. This decrease brings the percentage of campaigns at the largest companies roughly in line with 2015 and 2016. In general, the frequency of campaigns in each band of market capitalization has remained relatively steady since 2014. The following table sets forth by market capitalization the percentage of companies targeted by activist campaigns announced since the beginning of 2014, with the first row indicating the allocation of companies in the Russell 3000 Index (the “Russell 3000”) in each range.

### Target Company Market Capitalization

	\$100m–\$500m	\$500m–\$1b	\$1b–\$10b	\$10b–\$50b	>\$50b
Percentage of total companies	21%	14%	40%	12%	3%
2018 campaigns	40%	13%	34%	8%	3%
2017 campaigns	41%	16%	29%	7%	6%
2016 campaigns	44%	19%	29%	6%	2%
2015 campaigns	45%	15%	29%	8%	3%
2014 campaigns	42%	14%	33%	6%	5%
Five-year average	42%	15%	31%	7%	4%

Smaller companies tend to be targeted more frequently, with companies whose market cap is between \$100 million and \$500 million representing an average of 40% of campaigns in 2018, while representing only 21% of Russell 3000 companies. In contrast, companies with market caps between \$1 billion and \$10 billion are less likely to be targeted than their representation as a percentage of Russell 3000 companies suggests, as these companies represent an average of 31% of campaigns, while making up 40% of Russell 3000 companies.

On average, approximately 11% of the campaigns in each year targeted companies with market caps of greater than \$10 billion, with companies with market caps of greater than \$50 billion making up around 4% of total campaigns. Although companies with market caps greater than \$50 billion made up 6% of total campaigns in 2017 (while representing only 3% of Russell 3000 companies), the same category

made up only 3% of total campaigns in 2018. Despite this decrease, the past five years have made it clear that the largest companies are in no way immune from activist campaigns. For the companies that are currently in the Fortune 100, 25% have been targeted by a public activism campaign since 2013 and many others have dealt privately with activism situations.

**B. INDUSTRIES OF TARGET COMPANIES**

Activists have targeted a wide variety of industries since 2014. The most targeted industries, which have generally remained consistent in each year, include investment vehicles (including investment trusts and mutual funds), pharmaceutical companies, software companies and other commercial service providers.

***Most Targeted Industries 2014 to 2018<sup>24</sup>***

<i>Industry</i>	<i>Total Campaigns</i>
Real Estate Investment Trusts	79
Investment Trusts / Mutual Funds	71
Packaged Software	70
Integrated Oil	52
Miscellaneous Commercial Services	43
Pharmaceuticals: Major	39

One particular industry that has been targeted in 2018 more than in years past was integrated oil, which includes businesses engaging in the production, exploration, refinement and distribution of oil and gas. There were 22 campaigns announced against integrated oil companies in 2018 compared to an average of just over seven per year from 2014 through 2017.

<sup>24</sup> Industry classifications based on data from SharkRepellent.net. See “Notes on the Scope and Sources of Data Used in This Publication” on page 4.

# 4 INSTITUTIONAL INVESTORS

The influence of large index funds and other institutional investors is central to outcomes of shareholder activism contests. Despite the growth of activist investing in recent years, activists in the aggregate hold a very small percentage of public company stock. Even in companies where they launch campaigns, activists usually do not hold enough stock for those holdings to play a determinative role in vote outcomes. For campaigns launched in 2018, the median percentage ownership of the dissident group was approximately 7% and was less than 2% at companies with a market cap of over \$20 billion. In many cases, an activist will have additional exposure to the target through various derivative positions, but those positions often do not give the activist the right to vote the underlying shares.<sup>25</sup>

In any event, in order to succeed in proxy contests or other campaigns, activists depend on the support of large institutional investors. These large investors, particularly index fund managers, are well aware of their critical role. Accordingly, before turning to a detailed discussion of the types and objectives of activist campaigns, this section highlights trends among the large institutional investors.

## A. CONCENTRATION AMONG LARGEST INSTITUTIONAL INVESTORS

Concentration of equity ownership, particularly among the largest three index fund providers, continues to be a key component in the activism landscape. As of December 2018, one of BlackRock, Vanguard or State Street was the largest shareholder in 438 of the S&P 500 companies, roughly 88 percent, and collectively the three firms owned 18.7% of all shares in the S&P 500.<sup>26</sup> Fidelity is the fourth-largest institutional investor and its ownership also significantly contributes to the equity concentration of the S&P 500.

In prior memoranda, we have discussed the possibility that universal proxy cards, in which management and shareholder nominees are included on a single ballot rather than two separate ballots, could make this concentration of share ownership even more impactful. We observed that if a dissident shareholder could trigger the use of

<sup>25</sup> Where an activist investor uses derivative positions to hedge its exposure to an issuer, some have argued that this weakens the activist's argument that it is aligned with other shareholders. For example, in Elliott's approach of Telecom Italia, it used a "collar" to protect a portion of its stake, leading Telecom Italia's largest shareholder, Vivendi, to argue that Elliott's interests were misaligned with other shareholders. See *The Wall Street Journal*, *How Activists Buy Two Votes With One Share* (Mar. 4, 2019).

<sup>26</sup> See Russell Reynolds Associates, *2019 Global & Regional Corporate Governance Trends* (Dec. 11, 2018). As of 2017, Vanguard alone owned more than five percent of 491 companies in the S&P 500. Leslie P. Norton, *Jack Bogle's Battle – Correction Appended*, *BARRON'S* (Jan. 17, 2019).

As of December 2018, one of BlackRock, Vanguard or State Street was the largest shareholder in 438 of the S&P 500 companies, roughly 88 percent.

a universal proxy card by reaching out to a small number of large shareholders, it would be much less costly for activists to run a proxy contest. The topic gained renewed traction this year when, in June 2018, SandRidge Energy used the first-ever universal proxy card in its proxy contest with Carl Icahn.<sup>27</sup> A universal proxy card was also proposed in proxy contests with Cars.com and Mellanox Technologies over the course of the year. Although the renewed interest has not led to regulatory change, the SEC implied that it remains open to the idea by including it on the agenda of items discussed at the Roundtable on the Proxy Process held on November 15, 2018.<sup>28</sup>

## B. SHIFT FROM RETAIL TO INSTITUTIONAL OWNERSHIP

There continues to be a significant difference between the levels of retail and institutional ownership of public companies. Over the past three years, retail ownership of all U.S. public companies has hovered around 30%.<sup>29</sup> Meanwhile, as of September 30, 2018, companies in the S&P 500 were approximately 84% owned by institutional investors.<sup>30</sup>

The difference between retail and institutional ownership underscores the relative voting power exercised by institutional investors. In 2018, consistent with past years, only 28% of retail-held shares were voted, compared to 91% of shares held by institutions.<sup>31</sup> The difference in voting participation is the result of several factors.

- First, in many cases, institutional investors are required to vote their shares because of fiduciary duties, while there is no requirement for retail investors to vote their shares.
- Second, the use of notice-and-access for delivery of proxy materials to shareholders has contributed to declining voter participation among retail investors.<sup>32</sup>
- Third, the diminishing voting participation of retail shareholders has been amplified by the elimination of broker discretionary voting on uninstructed “street name” shares.

As institutional investors continue to amass voting power, they also are becoming significantly more self-reliant in making voting determinations. The frequency with which many of the largest

<sup>27</sup> MacKenzie Partners, Inc., *The Universal Proxy Gains Traction: Lessons from the 2018 Proxy Season* (Sept. 19, 2018), available at <https://corpgov.law.harvard.edu/2018/09/19/the-universal-proxy-gains-traction-lessons-from-the-2018-proxy-season/>.

<sup>28</sup> See U.S. Securities and Exchange Commission, *Roundtable on the Proxy Process* (Nov. 15, 2018), available at <https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf>.

<sup>29</sup> *ProxyPulse*, 2018 Proxy Season Review, 2017 Proxy Season Review and 2016 Proxy Season Wrap-up.

<sup>30</sup> Based on data from FactSet Research Systems, Inc. as of February 1, 2019, sourced from Form 13-F filings.

<sup>31</sup> *ProxyPulse*, 2018 Proxy Season Review. This relates to overall votes; not merely contested matters.

<sup>32</sup> The concerns over reduced retail participation when notice-and-access is used are discussed in *SEC Release No. 33-9108* (Feb. 22, 2010).



institutional investors vote with ISS and Glass Lewis has dropped in the last three years; for example, BlackRock's voting alignment with ISS has dropped from 61% in 2016 to 31% in 2018.<sup>33</sup>

The multi-tiered system of beneficial ownership of U.S. equity securities continues to complicate efforts to verify the legitimacy of investor participation in proxy contests. The Trian campaign at P&G, where it took the inspector of elections 66 days to finalize the vote count, is one high-profile example of the shortcomings of this system. In 2018, proxy voting reform continued to be an area of focus in the industry and was a key discussion point at the SEC Investor Advisory Committee meeting, held on September 13, 2018.<sup>34</sup> Further, Broadridge has reportedly spent approximately \$150 million looking into how to use blockchain technology to innovate proxy voting (and other applications).<sup>35</sup> In March 2018, Broadridge teamed up with Santander to pilot a blockchain ballot at Santander's annual meeting.<sup>36</sup> This comes after the July 2017 announcement that Delaware had amended the Delaware General Corporation Law to include several blockchain-related provisions, including the possibility of using blockchain technology to create and administer stock ledgers.<sup>37</sup>

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<sup>33</sup> See Moelis & Company, *Activist Shareholder Advisory Discussion Materials* (Jan. 2019).

<sup>34</sup> Pensions & Investments, *Drumbeat grows louder for proxy voting reforms* (Oct. 1, 2018).

<sup>35</sup> See Barrons, *Blockchain Could Help Fix Proxy Voting Problems* (July 6, 2018).

<sup>36</sup> See Financial Times, *Santander shows potential of blockchain in company votes* (May 17, 2018). Approximately one-fifth of Santander's shareholders utilized the blockchain system, which Santander considered a "true success." See Barrons, *Blockchain Could Help Fix Proxy Voting Problems* (July 6, 2018).

<sup>37</sup> See 8 Del. C. § 224 (2018).

# 5 TYPES AND OBJECTIVES OF ACTIVIST CAMPAIGNS

Initiating or threatening to initiate a proxy contest for board representation is a common strategy used by activists to achieve their campaign objectives. A proxy contest occurs when an activist nominates one or more directors for election in opposition to a public company’s slate of director nominees. Activists also conduct campaigns through other avenues and tactics, all of which we have included in the general category of “other stockholder campaigns”; this can include publicly disclosing letters to target companies, issuing press releases, proposing precatory or binding shareholder proposals, running “vote no” campaigns against incumbent directors, calling special meetings or taking actions by written consent.

## A. FREQUENCY OF DIFFERENT CAMPAIGN TYPES

2018 saw a 5.5% increase in the number of activist campaigns, including both proxy contests and other stockholder campaigns, following a slight reduction in 2017. The number of activist campaigns in 2018 was generally in line with five-year averages.

### *Number of Campaigns Announced Per Year*

	<i>Proxy Contests</i>	<i>Other Stockholder Campaigns</i>	<i>Total</i>
2018	51	217	268
2017	47	207	254
2016	49	218	267
2015	73	227	300
2014	62	210	272
Five-year average	56	216	272

On average, approximately 21% of activist campaigns have taken the form of actual proxy contests in the past five years. The actual percentage of proxy contests compared to total announced campaigns in 2018 was slightly below average at 19%, but this number can be explained in part by the fact that some of the campaigns currently categorized as “Other Stockholder Campaigns” may yet evolve into actual proxy contests in 2019.

## B. UNDERLYING OBJECTIVES OF ACTIVIST CAMPAIGNS

Although board representation remains the most common objective in activist campaigns, it is almost always sought in conjunction with other underlying objectives. In past years, the most common underlying objectives of proxy contests related to business strategies, balance-sheet actions (such as returning cash to shareholders through dividends or share repurchases, which are often related to capital allocation strategies) and divestitures or other M&A actions (such as encouraging a sale of the company or opposing a merger). In 2018, proxy contests focused mostly on balance-sheet issues (such as concerns about the capital structure of the company) and M&A actions. The number of proxy contests focusing on board-related governance fell dramatically in 2018 after seeing a jump in 2017, and fell far below the five-year average.

### *Objectives of Proxy Contests*<sup>38</sup>

<i>Issue</i>	<i>2014</i>	<i>2015</i>	<i>2016</i>	<i>2017</i>	<i>2018</i>	<i>Five-year average</i>
Business Strategies	44%	34%	21%	15%	12%	25%
Balance Sheet	35%	53%	21%	60%	25%	39%
M&A	27%	40%	21%	13%	27%	26%
Board-Related Governance	26%	26%	23%	51%	14%	28%
Compensation	5%	11%	10%	23%	10%	12%
Other Governance	19%	8%	2%	15%	6%	10%

### *Underlying Objectives of Other Stockholder Campaigns*<sup>38</sup>

<i>Issue</i>	<i>2014</i>	<i>2015</i>	<i>2016</i>	<i>2017</i>	<i>2018</i>	<i>Five-year average</i>
Business Strategies	23%	24%	24%	47%	29%	30%
Balance Sheet	26%	21%	17%	37%	44%	29%
M&A	31%	37%	34%	29%	39%	34%
Board-Related Governance	7%	11%	13%	26%	12%	14%
Compensation	4%	7%	5%	5%	7%	6%
Other Governance	0%	2%	1%	3%	5%	2%

<sup>38</sup> The percentages in these tables often add up to over 100% because single campaigns often have multiple objectives.

Activists have initiated litigation in roughly two to four percent of campaigns each year for the past five years.

### C. TACTICS USED BY ACTIVISTS

The most common tactics in the activist's playbook (other than nominating a director slate) are publicity campaigns (including publicly disclosing presentations about the company or letters to the company, issuing press releases, establishing websites and using Twitter and social media). In 2018, publicity campaigns largely returned to their pre-2017 levels; activist investors made public disclosures in 40% of 2018 campaigns. Other tactics that are used from time to time, including initiation of litigation and the calling of a special meeting, happen relatively rarely—in less than five percent of campaigns over this period.

### D. LITIGATION TACTICS USED BY ACTIVISTS

One less frequent, but important, tool in the activist's toolbox is the initiation or threat of litigation. Activists have initiated litigation in roughly two to four percent of campaigns each year for the past five years. Some of the more notable campaigns involving litigation by activists in 2018 included: (1) John Schnatter's attempts to retake control of Papa John's; (2) Carl Icahn's opposition to each of AmTrust Financial Services, Inc.'s going private transaction and Dell Technologies, Inc.'s recapitalization to eliminate its VMWare tracking stock; (3) Third Point's campaign against Campbell's Soup; (4) Albert Ratner's unsuccessful attempt to block the acquisition of Forest City Realty Trust (of which he was co-Chairman emeritus and former CEO) by Brookfield Property Partners; and (5) Darwin Deason's successful efforts to block the Xerox-Fujifilm combination.

Activist-initiated litigation tends to involve Section 220 (books and records) demands, breach of fiduciary duty claims and/or allegations regarding violations of the federal securities laws.<sup>39</sup> Litigation can serve several purposes—in addition to attempting to achieve success on the merits of the claim, activists can use litigation for the purposes of frustration and delay,<sup>40</sup> as an additional platform for airing grievances and as an additional source of pressure on targeted companies and boards. Activists can also leverage interim orders and judgments to bolster their causes (a hollow success on a motion for discovery can be spun in the press as an indication that the underlying claim or agenda has merit, for instance), and use discovery as a tool for ferreting out damaging or embarrassing e-mails and other documents (whether or not ultimately directly related to the matter being litigated). On this last point, the Chancery Court's ruling in

<sup>39</sup> These claims can sometimes raise novel issues—for instance, consider Icahn's campaign against AmTrust Financial Services, Inc. where Icahn questioned the applicability of the Delaware Chancery Court's *Kahn v. M&F Worldwide Corp.* holding in situations where actions of the acquiror may have been aimed at disenfranchising minority shareholders who acquired shares following the announcement of the sale but before the public announcement of the record date for the vote—but can also proceed on well-defined premises resulting in more legally mundane conclusions.

<sup>40</sup> For instance, in Brookfield's acquisition of Forest City Realty Trust, Mr. Ratner sued to enjoin the target's shareholder vote a mere 60 hours prior to its scheduled occurrence.

*Schattner v. Papa John's Intl, Inc.*, C.A. No. 2018-0542-AGB (Del. Ch. 2019) serves as a reminder of the broad right of directors (not just stockholders) to inspect books and records (including texts and e-mails sent via personal phones and e-mail accounts), and reaffirms the benefits of obtaining contractual waivers of Section 220 demand rights in any settlement that involves giving an activist a board seat.

Third Point's campaign to control Campbell Soup's strategic review process is also illustrative. Third Point acquired a position in Campbell's stock in August of 2018 and proceeded with a public letter campaign, the establishment of its "Refresh Campbell's" website and the nomination of a competing full slate of directors. Shortly following Campbell's own subsequent proxy filing, and only about a month prior to the scheduled annual meeting, Third Point sued Campbell's, accusing its directors of breaching the fiduciary duty of disclosure by, among other things, failing to disclose the incompetence and conflicts of interest of certain of its nominees and requesting that Campbell's annual meeting be delayed (though not stated, presumably to give Third Point more time to promote its investment thesis and competing slate of directors). The complaint was subsequently made part of a public securities filing by Third Point and covered by major media outlets, including CNBC, Bloomberg and Reuters. Third Point ultimately lost its motion for expedited discovery and expedited hearing for a preliminary injunction, but the court's decision did not dismiss the lawsuit or bar Third Point from proceeding with broad discovery, deposition and documentary requests, which some commentators viewed as an attempt by Third Point to gather embarrassing documentation that it could use in connection with its proxy fight.<sup>41</sup> Although Third Point was unsuccessful in replacing Campbell's entire board, it did negotiate the right to nominate two directors to Campbell's board through a settlement reached with Campbell's later in the year.

Of course, activists are not the only ones doing the litigating. In 2018, the Delaware Chancery Court decided *In re PLX Technology Inc. S'holders Litig.*, C.A. No. 9880-VCL (Del. Ch. 2018). Perhaps most notable for its focus on short-termism as a basis for finding a conflict of interest and its finding that Potomac Capital Partners, as an activist investor, could be liable for aiding and abetting PLX Technology Inc.'s directors' breach of their fiduciary duties as a result of the actions of its employee on the PLX board, the Chancery Court's opinion serves as a reminder that (1) fiduciary duties of directors run to a company's shareholders broadly, not to activists, and boards must conduct themselves accordingly, even in the face of activist pressure, and (2) an activist's objectives may differ from those of other shareholders and therefore its affiliated director designee(s) may be conflicted in the pursuit of that objective.

<sup>41</sup> See, e.g., Reuters, *Third Point Sues Campbell Soup, Accuses It of Misleading Investors* (Oct. 25, 2018) (available at <https://www.reuters.com/article/us-campbell-soup-lawsuit-third-point/third-point-sues-campbell-soup-accuses-it-of-misleading-investors-idUSKCN1MZ2WP>).



In addition, Elon Musk's recent settlement with the SEC over his take-private tweet, and continued legal trouble over subsequent tweets,<sup>42</sup> provides a reminder that, even under pressure from activists (or, in Mr. Musk's case, short sellers), care must be taken in public communications regarding present intentions and corporate strategy.

## E. COMPANY RESPONSES TO ACTIVISM

Targeted companies utilize a variety of structural and behavioral actions to respond to activist campaigns. Actions taken by target companies in response to campaigns include:

- hiring advisors and taking substantive business steps (such as evaluating strategic alternatives with or without a public announcement, and returning cash to investors through dividends or buybacks);
- governance changes (including those viewed as governance enhancements by shareholders); and
- tactical actions (such as adoption or revision of poison pills, calling of a special meeting, adjourning or postponing meetings, initiation of litigation or changing board size).<sup>43</sup>

More aggressive tactical steps, such as adoption of poison pills and initiation of litigation, remain relatively uncommon during a campaign.<sup>44</sup> Lastly, target board size changes and share buyback announcements in response to activist campaigns decreased sharply below five-year averages.

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<sup>42</sup> See New York Times, *S.E.C. Asks Court to Hold Tesla's Elon Musk in Contempt for Twitter Post on Production* (Feb. 25, 2019).

<sup>43</sup> The categorizations of defensive actions taken are derived from categories reported by SharkRepellent.net.

<sup>44</sup> Notably, in February, Sinovac Biotech Ltd. became the first company to activate a poison pill in more than a decade. See Reuters, *Sinovac Biotech activates 'poison pill' defense in rare move* (Feb. 22, 2019).

## ***Actions Taken by Target Companies in Response to Activism***

	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>Five-year average</b>
<b><i>Substantive Actions</i></b>						
Act to Increase Shareholder Value (e.g., buybacks or dividends)	8%	21%	12%	15%	10%	13%
Announce Hiring of Advisors to Evaluate Strategic Alternatives	3%	8%	7%	8%	6%	6%
<b><i>Governance Changes</i></b>						
Amend Advance Notice Requirements	2%	4%	3%	2%	2%	3%
Other Charter/Bylaw Changes	5%	10%	3%	9%	5%	6%
Corporate Governance Enhancement	1%	3%	4%	2%	2%	2%
<b><i>Tactical Actions</i></b>						
Increase Size of Board	5%	17%	10%	10%	6%	10%
Adopt Poison Pill	7%	1%	2%	3%	2%	3%
Adjourn Meeting	0%	1%	2%	2%	2%	1%
Postpone Meeting Date	1%	3%	2%	2%	2%	2%
Amend Poison Pill	0%	1%	1%	<.5%	1%	1%
Decrease Size of Board	2%	3%	2%	4%	0%	2%
Call Special Meeting	1%	1%	1%	1%	2%	1%
Initiate Litigation	<.5%	1%	0%	2%	1%	1%

# 6 PROXY CONTESTS<sup>45</sup>

Initiating a proxy contest for representation on a company’s board of directors is one of the primary strategies used by activists to achieve their campaign objectives.<sup>45</sup> Defending against a proxy contest requires a public company to expend considerable time and resources as it undertakes to demonstrate to its shareholders that its director candidates are better positioned to lead the company and the company and the board and management are likely to be subject to repeated attacks throughout the course of the proxy contest. It also requires the company and its management and board to absorb and respond to a steady stream of public criticism. As a result, many companies rationally choose to settle with an activist for limited board representation and a standstill agreement, and accept the risk of prolonged controversy and disruption in the boardroom, rather than taking the risks associated with a public proxy contest (see below under the heading “Settlement Agreements” for a more detailed discussion on settlements). This section analyzes key statistics and trends regarding proxy contests, which may help inform strategies for approaching a potential proxy contest.

However, these overall statistics tell only part of the story, as the decision whether or not to settle in individual cases depends upon the particular facts and circumstances. Moreover, as other statistics provided below demonstrate, the consequences of accepting dissident directors can be profound.

## A. HOW OFTEN ARE PROXY CONTESTS SETTLED?

### *Proxy Contests: Frequency of Votes, Settlements and Withdrawals*

	Total Number	Went to Vote	Percentage	Settled/ Concessions Made	Percentage	Withdrawn	Percentage
2018	51	17	33%	22	43%	5	10%
2017	47	17	36%	19	40%	11	23%
2016	49	15	31%	22	41%	12	25%
2015	73	26	36%	35	48%	12	16%
2014	62	14	23%	32	52%	16	26%

<sup>45</sup> Percentages for 2018 proxy contests throughout this section may not add up to 100% because the total number of 2018 proxy contests includes proxy contests that are still pending (i.e., campaigns announced in late 2018 for the 2019 proxy season).

The total number of proxy contests has been stable over the past three years, following a significant drop-off in the number of reported proxy contests in 2016. The recent stabilization in terms of the number of proxy contests in a given year likely reflects a trend toward engaging in private discussions with activist investors to resolve their concerns before a potential proxy contest is made public.

### ***Proxy Contests Settled After the Date of the Definitive Proxy Statement***

	<i>Proxy Contests That Went Definitive</i>	<i>As a Percentage of Total Proxy Contests</i>	<i>Proxy Contests Settled After Definitive Date</i>	<i>As a Percentage of Proxy Contests That Went Definitive</i>
2018	24	47%	6	25%
2017	24	51%	5	21%
2016	25	51%	7	28%
2015	36	49%	5	14%
2014	23	37%	5	22%

Each year since 2015, roughly half of the proxy contests extended beyond the date that the proxy statements for both sides went “definitive”—in other words, closer in time to the date of the shareholders’ meeting at which directors are elected. Of these, issuers and activists generally settled, on average, one in four contests.

## **B. RESULTS OF RECENT PROXY CONTESTS**

### ***Proxy Contests – Short vs. Control Slate***

	<i>Number of Proxy Contests With Short Slate</i>	<i>Percentage of Proxy Contests With Short Slate</i>	<i>Activist Wins at Least One Board Seat (Short Slate)</i>	<i>Number of Proxy Contests With Control Slate</i>	<i>Percentage of Proxy Contests With Control Slate</i>	<i>Activist Wins at Least One Board Seat (Control Slate)</i>	<i>Activist Wins Majority of Board Seats (Control Slate)</i>
2018	16	31%	50%	35	69%	46%	9%
2017	23	49%	52%	24	51%	38%	8%
2016	13	27%	39%	36	74%	36%	8%
2015	24	33%	42%	49	67%	39%	8%
2014	18	29%	67%	44	71%	52%	14%

The percentage of proxy contests involving a control slate, or a slate for a majority of the board seats, has ranged from 51% to 74% from 2014 to 2018. This suggests that, once activists invest in formally commencing a proxy contest, many are not content to merely gain a

seat at the table to influence the direction of the company but rather are seeking the ability to control the direction of the company, or at a minimum are willing to threaten a control attempt in order to gain negotiating leverage.<sup>46</sup> Control slates returned to more typical levels after a sharp decline in the number of control slate contests (as a percentage of total contests) in 2017 as compared to prior years.

Over the last five years, approximately 45% of all proxy contests, control slates or short slates (a slate for a minority of the board seats) resulted in the activist investor obtaining one or more seats on the board. However, for each year in our study, short slate contests are somewhat more successful than control slate contests by this measure.

**Short Slate Contests – Number of Board Seats Sought<sup>47</sup>**

	<i>Number of Short Slate Contests</i>	<i>Dissident Nominates 1 Candidate</i>	<i>Dissident Nominates 2 Candidates</i>	<i>Dissident Nominates &gt; 2 Candidates</i>
2018	16	5	3	8
2017	23	2	10	11
2016	13	5	5	3
2015	24	2	13	9
2014	18	2	6	10

When an activist investor puts forward a short slate of directors, they typically nominate two or more director candidates. Over the past five years, activists have sought multiple board seats in approximately 80% of short slate contests each year on average. In 2018, a greater percentage of short slate contests involved activists seeking only one board seat, but activists still sought multiple board seats in the majority of short slate contests.

<sup>46</sup> The ability of an activist to launch a campaign for a control slate may be limited by regulatory restrictions in certain industries, such as the financial services industry.

<sup>47</sup> The information in this chart is based on data from SharkRepellent.net, and is supplemented with publicly available information. See “Notes on the Scope and Sources of Data Used in This Publication” on page 4.



### ***Proxy Contest Settlement Frequency – Short vs. Control Slate***

	<b><i>Number of Short Slate Contests</i></b>	<b><i>Percentage of Short Slate Contests Settled/ Concessions Made</i></b>	<b><i>Number of Control Slate Contests</i></b>	<b><i>Percentage of Control Slate Contests Settled/ Concessions Made</i></b>
2018	16	50%	35	40%
2017	16	48%	24	33%
2016	13	31%	36	58%
2015	24	25%	49	60%
2014	18	44%	44	54%

For the three years before 2017, when an activist investor put forward a short slate of directors, the issuer and activist investor ended up agreeing to settle the contest before a vote approximately 32% of the time on average. In the past two years the settlement percentage has been significantly higher. In 2017, the settlement percentage jumped to 48%; in 2018, the percentage increased to 50%, the highest percentage in our study. In the context of control slates, for the three years before 2017, the issuer and activist investor agreed to settle the contest before a vote approximately 57% of the time on average. In 2017, however, that percentage dropped to 33% and increased slightly to 40% in 2018. This data does not appear to present a clear trend, either relatively or absolutely.

The inconsistency in the frequency of the pre-vote resolution of proxy contests in the short versus control slate contexts may have a number of explanations. One explanation is that management may be predisposed to settling in the context of a short slate contest because it may be more difficult to justify the monetary and reputational cost of publicly fighting an activist that is seeking only one or two board seats. In contrast, in the control slate context, an issuer may be less likely to be able to settle with the activist on acceptable terms and may be increasingly willing to defend the company's incumbent directors and strategic direction in a public forum. Issuers' decisions in these cases have been bolstered by data showing that an issuer is more likely to prevail in a control slate contest than the activist.<sup>48</sup>

<sup>48</sup> As shown above, over the past five years, activists have won at least one board seat in roughly 42% of control slate contests per year and have won a majority of board seats in roughly 9% of control slate contests per year over the same period.

### ***Outcome of Proxy Contests That Went to a Vote***

	<i><b>Won by Issuer</b></i>		<i><b>Won by Activist</b></i>		<i><b>Vote Split</b></i>	
2018	7	41%	8	47%	2	12%
2017	12	71%	4	24%	1	6%
2016	12	80%	3	20%	0	0%
2015	17	65%	7	27%	2	8%
2014	6	43%	8	57%	0	0%

Of the proxy contests that go all the way to a vote, until recently incumbent board candidates had been increasingly successful in defeating activist investors' slates of directors. The margin of success for companies began to decline and fell to a five-year low in 2018. The reasons for the companies' declining success rate vary from campaign to campaign and may result, in part, from an increase in the savviness of activists, improvements in the quality of their director nominees and their increasing appeal to institutional shareholders.

### ***Outcome of Proxy Contests That Went to a Vote – Short vs. Control Slate***

	<i><b>Short Slate Contests</b></i>			<i><b>Control Slate Contests</b></i>		
	<i><b>Won by Issuer</b></i>	<i><b>Won by Activist</b></i>	<i><b>Vote Split</b></i>	<i><b>Won by Issuer</b></i>	<i><b>Won by Activist</b></i>	<i><b>Vote Split</b></i>
2018	33%	67%	0%	43%	43%	14%
2017	80%	10%	10%	57%	43%	0%
2016	60%	40%	0%	89%	11%	0%
2015	67%	27%	7%	64%	27%	9%
2014	33%	67%	0%	50%	50%	0%

From 2015 to 2017, issuers won short slate contests that went to a vote between 60% and 80% of the time. That success rate for short slate contests dropped to 33% in 2018. One possible explanation for the drop is that activist investors have become more selective when pursuing short slate contests. In addition, the limited success of short slate campaigns in the preceding three years, activists may have become increasingly committed to their short slate campaigns and dedicated the necessary resources to see those campaigns through to the finish line.

Similarly, between 2015 and 2017 incumbent slates of directors experienced a fairly rapid year-over-year increase in their success rate with respect to winning control slate votes. In 2018, however, issuer success in control slate contests hit the lowest rate in five years. Although the activist success rate for control contests stayed the same

in 2017 and 2018, a vote split in 2018 occurred in 14% of control contests.

### C. WHAT OCCURS IN THE AFTERMATH OF A PROXY CONTEST?

#### *Company Changes in the Aftermath of a Proxy Contest*

	<i>CEO Change</i>	<i>Merger or Spin-off</i>	<i>Additional Proxy Contests</i>
2018	6%	6%	0%
2017	9%	9%	28%
2016	7%	14%	21%
2015	11%	14%	11%
2014	44%	31%	0%

The conclusion of a proxy contest, regardless of the outcome, is often a precursor to change for the company. In the year or so after a proxy contest, it is not uncommon to see changes to senior management or the board of directors, strategic initiatives such as mergers or spin-offs or the continuation of activist efforts through additional future proxy contests (whether waged by the same or another activist). The table above presents how often certain changes or events occur in the aftermath of all proxy contests that go to a vote. Note that because these changes can take time, the 2017 and 2018 data should be considered in light of the fact that enough time may not have elapsed since each proxy contest concluded for some of these changes to take place. Anecdotally, many practitioners believe the incidence of CEO turnover resulting from activism is actually much higher.

There have been fewer CEO changes and mergers or spin-offs from 2015 to 2018, and the likelihood of additional proxy contests declined. However, changes to the board have increased notably since 2014 and have consistently impacted a majority of the target companies after a proxy contest that went to a vote. Activist funds are now holding investments longer, often up to five years, and focusing initially on operational turnarounds. It is possible that activists have had no choice but to adapt to a longer time frame as companies susceptible to quick fixes have largely disappeared due to preemptive actions by boards and prior activist campaigns. We expect that, if operational and share price targets are not achieved, the push for another solution will become more urgent and be reflected in CEO change or merger/spin-off activity at the same rates as appeared in our data for 2014 and 2015.

Interestingly, the frequency of these types of changes does not seem to depend heavily on the outcome of the contest – that is, whether management or the activist won or the vote was split. This may reflect the fact that activists do not typically withdraw following a contest. They often continue campaigns after a lost vote, many times

successfully. It may also indicate that the issues raised during the course of the contest, including those raised by the activist and those arising in shareholder outreach discussions, can in some cases lead the board and management to conclude that responsive steps should be taken even if the management slate wins.

Lastly, no discussion of the aftermath of activist contests would be complete without pointing out that activists are not always successful in delivering the results promised by their campaigns. A good example (but by no means the only example) of this phenomenon is Trian's investment at GE.<sup>49</sup>

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<sup>49</sup> See Fortune, *The Investor That Tripped on GE & P&G* (Nov. 26, 2018).

# 7

## SETTLEMENT AGREEMENTS

This section analyzes the publicly filed settlement agreements that have been reached for activist campaigns announced in 2018 as compared to the prior three years, including the frequency of settlements, the timing of reaching a settlement and the key provisions of settlement agreements.

### A. FREQUENCY AND SPEED OF SETTLEMENT AGREEMENTS

The percentage of settlement agreements that have been filed with the SEC for 2018 campaigns to date as compared to the total number of completed activist campaigns increased slightly after decreasing significantly in 2017. This trend was consistent for proxy contests as well as other stockholder campaigns.

<i>Settlement Agreements Filed with the SEC</i>			<i>Filed Settlement Agreements for Proxy Contests</i>		<i>Filed Settlement Agreements for Other Stockholder Campaigns</i>	
	<i>Number</i>	<i>Percentage of Total Completed Campaigns</i>	<i>Number</i>	<i>Percentage of Total Proxy Contests</i>	<i>Number</i>	<i>Percentage of Total Other Stockholder Campaigns</i>
2018	45	17%	15	26%	30	15%
2017	38	15%	11	27%	27	12%
2016	66	41%	15	43%	33	40%
2015	81	25%	22	28%	59	24%

The speed with which settlement agreements have been reached in 2018 is generally in line with each of the prior three years. For the purposes of these calculations, the time when an activist initiates a campaign is deemed as the time when it makes the first public step towards achieving its goal, either by publicizing a letter sent to the company, sending a letter to the other shareholders, filing a Schedule 13D or otherwise publicly announcing its intent to initiate a campaign. Of course, in many cases the company and the activist will have had extensive discussions prior to there being any public knowledge of the campaign, and the first public announcement may come in the form of a finalized settlement agreement between the parties. In some instances, the campaign and settlement were announced on the same day, indicating that pre-settlement discussions occurred in private prior to any public announcement of the campaign. These instances were excluded for purposes of calculating the durations outlined in the



table below, although they represented 24% of the settlements we reviewed for 2018.

<i>Time between the Initiation of Campaigns and the Date of the Settlement Agreements</i>	<i>Less than 1 month</i>	<i>1–2 months</i>	<i>2–3 months</i>	<i>3–6 months</i>	<i>6 months or more</i>
2018	29%	18%	24%	24%	6% <sup>50</sup>
2017	33%	17%	11%	33%	6%
2016	23%	19%	21%	25%	12%
2015	15%	23%	19%	21%	21%

For the purpose of comparison and review, we have chosen not to examine settlement agreements that are either simple appointment letters without any standstill provisions or confidentiality agreements that do not have customary settlement agreement provisions. In addition, in the past two years, where multiple settlement agreements were filed for the same campaign, either because there were multiple activists or because one activist launched campaigns against several affiliates, we limited our review to one settlement agreement.

**B. NOMINATION PROVISIONS AND MINIMUM SHAREHOLDING PROVISIONS**

The majority of settlement agreements relating to 2018 activist campaigns provide for the appointment of a director to the board. The remaining agreements either provide for the nomination of a director candidate or some other arrangement, such as the appointment of an activist as a board observer. A plurality of 35% of settlement agreements reviewed provide for the nomination and/or appointment of two directors to the board, while 15% of agreements cover four or more directors. Compared to 2017, fewer of the agreements that provide for the nomination and/or appointment of new directors are limited to a single director, with notable increases in the proportion of settlements covering two or three directors.

<sup>50</sup> 2018 data for longer-term periods is likely artificially low, because the data includes only completed campaigns, and long-running campaigns announced in mid-2017 will not yet have been completed. This played out in our January 2018 analysis of settlement agreements where we reported that 0% of 2017 settlement agreements had been reached in six months or more year-to-date. Now that more agreements have been reported, this number is up to 6%. We would expect a similar increase in the 2018 numbers.

<b><i>Directors in Settlement Agreement</i></b>	<b><i>2018 Percentage</i></b>	<b><i>2017 Percentage</i></b>
4+ directors	15%	16%
3 directors	17%	10%
2 directors	35%	33%
1 director	20%	40%
No directors	13%	1%

The appointment of one or more new directors pursuant to a settlement agreement led to a board-size change in 70% of 2018 settlement agreements reviewed, up from 49% in 2017. The change in board size was generally an increase to make room for new nominees, but in some cases there were removals from the board in conjunction with the agreements that led to a decrease in board size. Additionally, of the agreements that provide for an increase in board size, several agreements call for the board size to be decreased following the subsequent annual meeting. When agreements do not provide for a board-size increase, the parties often explicitly agree which incumbent directors will resign to make room for the new director.

<b><i>Board Size Change</i></b>	<b><i>2018 Percentage</i></b>
Yes, by 4+ members	2%
Yes, by 3 members	15%
Yes, by 2 members	30%
Yes, by 1 member	22%
None	30%

65% of 2018 settlement agreements reviewed have provisions requiring minimum shareholding of the activists in order to keep the directors nominated by such activists on the board or to nominate replacements if such directors resign or are otherwise unable to serve. This represents a 13-percentage-point increase from 52% of settlement agreements reviewed for 2017. While the exact ownership level varies, minimum shareholding provisions often permit the investor to dispose of around 50% of its holdings at the time of the agreement. Failure to maintain the threshold may result in the nominees being required to resign from the board, the activist losing the right to name a replacement nominee or the termination of the agreement.

### **C. BOARD SEATS PURSUANT TO SETTLEMENT AGREEMENTS**

We further analyzed data from select campaigns by certain prominent activist funds from 2010 to January 2019 that resulted in settlements granting the fund the right to appoint at least one director to the board of the target company. We specifically looked at the frequency

with which these activists chose to have at least one fund insider appointed to the board, as well as the length of time that the longest-serving insider appointed pursuant to a settlement agreement remained on the board. As shown in the chart below, in 58% of the agreements, at least one of the appointed directors in our data set was an insider of the activist fund. Icahn, Pershing Square, Trian and ValueAct appointed an activist insider in over 85% of the settlements reviewed, whereas Elliott, Jana and Land & Buildings chose an insider in 25% or fewer of the settlements; Starboard and Third Point were almost evenly split between insiders and independents. In 53% of the agreements for which the duration of the settlement agreement has run, at least one insider stayed on the board longer than the length of time that the target company was required to appoint and nominate the director pursuant to the settlement agreement. For agreements in which at least one insider remained on the board for longer than the duration provided for by the settlement agreement, the longest-serving insider for each such agreement has served an average of approximately 27 months longer than the period provided for in the agreement. However, that average likely understates the total amount of time activist insiders stay on a target board following the expiration of the settlement period; in two-thirds of the agreements for which insider appointees remained on the board beyond the duration of the settlement agreement, at least one such nominee was still on the board as of January 2019. Furthermore, as of January 2019, in 11% of the agreements in which insiders were appointed, the insider nominees were still serving and the duration of the settlement agreement had not yet lapsed.

<i>Fund</i>	<i>Settlements Reviewed</i>	<i>% with Insider</i>	<i>% of Agreements with Insider Appointees on Board Beyond Duration of Settlement Agreement</i>	<i>Average Months Insider Appointees Are on Board Beyond Settlement</i>
<b>Elliott</b>	12	8%	100%	21
<b>Icahn</b>	15	87%	82%	26
<b>Jana</b>	9	22%	0%	N/A
<b>Land &amp; Buildings</b>	4	25%	100%	2
<b>Pershing Square</b>	2	100%	100%	48
<b>Starboard Value</b>	15	47%	20%	9
<b>Third Point</b>	5	60%	0%	33
<b>Trian Partners</b>	1	100%	0%	N/A
<b>ValueAct Capital</b>	11	100%	55%	31
<b>TOTAL</b>	78	58%	53%	27

## D. ONBOARDING OF NEW DIRECTORS

59% of the settlement agreements reviewed for 2018 include provisions providing for committee membership of the directors appointed or nominated under the agreement. Many agreements provide for appointment to specified key committees, while others mandate that any new committee formed in the future contain one or more of the activist's directors. Additionally, 13% of agreements reviewed require the formation of new board committees, compared to 19% for 2017 and 8% for 2015 and 2016. For example, in the Semptra-Elliott cooperation agreement, Semptra agreed to establish a "LNG and Business Development Committee" with a mandate to work with management and the board to conduct a comprehensive business review of the company. As at Semptra, the new committees are typically dedicated to a topic related to the activist campaign, with examples including the "Finance and Strategy Committee," "Business Development Committee" and "Operating Improvement Committee." Where the settlement agreements we reviewed do not provide for committee membership, the agreement either notes that the company must consider the nominee/appointee for committee membership along with other members of the board or is silent on committee membership.

78% of agreements reviewed for 2018 specifically address the topic of information-sharing by the new director with the activist, the same percentage as in 2017. However, in 2018, a lower proportion of agreements expressly permit the sharing of such information, down from 18% to 7%. 46% of agreements subject new directors to the board's standard policies regarding confidential information, while an additional 26% also involved confidentiality agreements, both of which were up roughly seven percentage points from 2017.

## E. STANDSTILL PROVISIONS

Almost every settlement agreement includes a standstill provision, which prohibits activists from engaging in certain activities within a prescribed period of time. The main purpose of the standstill provision is to restrict the activist from initiating or participating in any further campaigns. The standstill period generally runs from the date of the settlement agreement until a date tied to the time when the director nominated by the activist is no longer required to be nominated to serve on the board (or earlier upon a material breach by the company of provisions in the settlement agreement).

The following table lists the types of activities typically restricted by the standstill provisions and the frequency of their inclusion in 2018.

<b>% of 2018 Agreements</b>	<b>Activities Prohibited</b>
<b>91%</b>	<b><i>Soliciting proxies or consents.</i></b> Prohibits activists from making, engaging in or in any way participating in, directly or indirectly, any “solicitation” of proxies or consents to vote, or advising, encouraging or influencing any person with respect to the voting of any securities of the company.
<b>89%</b>	<b><i>Publicly disparaging the company or its directors or officers.</i></b> Prohibits activists from disparaging or negatively commenting on the company or its affiliates or any of their respective officers or directors, including the company’s corporate strategy, business, corporate activities, board or management. Of the settlement agreements we reviewed, 90% include a mutual non-disparagement clause that also prohibits the company from publicly disparaging the activists.
<b>89%</b>	<b><i>Seeking board additions or removals.</i></b> Prohibits activists from seeking to elect or remove any directors or otherwise seeking representation on the board.
<b>87%</b>	<b><i>Forming a group or a voting trust or entering into a voting agreement.</i></b> Prohibits activists from forming or participating in any Section 13(d) “group” with any persons who are not their affiliates with respect to any securities of the company or seeking to deposit any securities of the company in any voting trust, or subjecting any such securities to any voting agreements (other than any such voting trust, arrangement or agreement solely among the activists and their affiliates).
<b>85%</b>	<b><i>Presenting a shareholder proposal.</i></b> Prohibits activists from making any proposal at any annual or special meeting of the shareholders.
<b>83%</b>	<b><i>Calling shareholder meetings or referendums.</i></b> Prohibits activists from calling or seeking the company or any other person to call any meeting of shareholders, as well as action by written consent, or conducting a referendum of shareholders.



<b>% of 2018 Agreements</b>	<b>Activities Prohibited</b>
<b>72%</b>	<b><i>Seeking amendments or waivers from the standstill or challenging validity of the standstill.</i></b> Prohibits activists from publicly requesting any waiver of or amendment to the standstill provision or contesting the validity thereof. A majority of the settlement agreements include an exception that such actions could be pursued through non-public communications with the company that would not be reasonably determined to trigger public disclosure obligations.
<b>74%</b>	<b><i>Entering into third-party agreements that go against the settlement agreement.</i></b> Prohibits activists from entering into any discussions, negotiations, agreements or understandings with any third party with respect to any activities restricted by the standstill provision.
<b>70%</b>	<b><i>Seeking extraordinary transactions not recommended by the board.</i></b> Prohibits activists from seeking, facilitating or participating in “extraordinary transactions” not recommended by the board. The term “extraordinary transactions” is generally defined to include any tender or exchange offer, merger, consolidation, acquisition, scheme, arrangement, business combination, recapitalization, reorganization, sale or acquisition of assets, liquidation, dissolution or other extraordinary transaction involving the company. Some settlement agreements include an exception that the activists could still tender their shares into any tender or exchange offer or vote their shares with respect to any extraordinary transactions. The prohibition sometimes extends to making public communications in opposition to the extraordinary transactions approved by the board.
<b>65%</b>	<b><i>Bringing litigation or other proceedings (other than to enforce the settlement agreement).</i></b> Prohibits activists from instituting or joining any litigation, arbitration or other proceeding (including any derivative action) against the company or its directors or officers other than to enforce the provisions of the settlement agreement. Many settlement agreements also include exceptions for counterclaims with respect to any proceeding initiated by the company against the activists, exercise of statutory appraisal rights or responding to or complying with a validly issued legal process.

<b>% of 2018 Agreements</b>	<b>Activities Prohibited</b>
<b>61%</b>	<b><i>Requesting a shareholder list or books and records.</i></b>
<b>61%</b>	<b><i>Seeking to control or influence the company or the management.</i></b> While many settlement agreements simply provide for a flat prohibition on any actions designed to control or influence the company or management, some settlement agreements specify the types of activities that are prohibited, including any proposal to change the composition of the board, any material change in the capitalization, stock repurchase programs or dividend policy, any other material change in the company's management, business or corporate structure, amendments to the certificate of incorporation or bylaws, causing a class of securities of the company to be delisted from any securities exchange or become eligible for termination of registration pursuant to Section 12(g)(4) of the Exchange Act.
<b>59%</b>	<b><i>Publicly announcing intent to go against the settlement agreement.</i></b> Prohibits activists from making any public disclosure, announcement or statement regarding any intent, purpose, plan or proposal that is inconsistent with the standstill provisions.
<b>55%</b>	<b><i>Acquiring more shares.</i></b> Prohibits activists from acquiring, offering to acquire or causing to be acquired beneficial ownership of any securities of the company such that immediately following such transaction the activists would have beneficial ownership of securities exceeding a certain prescribed limit. Settlement agreements sometimes clarify that exceeding the limit as a result of share repurchases or other company actions that reduce the number of outstanding shares should not be counted as a breach of this clause.

<b>% of 2018 Agreements</b>	<b>Activities Prohibited</b>
<b>41%</b>	<b><i>Transferring shares to a third party.</i></b> Prohibits transfers of the company's securities to a third party that would result in such third party having aggregate beneficial ownership of more than a certain percentage. Many settlement agreements carve out certain parties from this restriction, such as parties to the settlement agreement, directors and officers of the company and/or affiliates of the company. A small number of settlement agreements also prohibit any purchase, sale or grant of any option, warrant, convertible security, stock appreciation right or other similar right.
<b>17%</b>	<b><i>Short selling.</i></b> Prohibits activists from engaging in short selling of the company's securities.

Once again, the frequency of activities prohibited in standstill agreements remained relatively stable from 2017 to 2018, with certain notable exceptions. Last year, we noted an increase in prohibitions on short selling from 17% across 2015 and 2016 to 32% in 2017 and a corresponding drop in prohibitions on transfers of shares to third parties from 46% to 29%. That trend reversed in 2018, with short selling prohibitions back down to 17% and prohibitions on transferring shares to third parties back up to 41%, both in alignment with 2015/2016 frequencies. However, as discussed above, there was a corresponding 13-percentage-point increase in settlement agreements containing minimum share ownership levels. Additionally, several agreements that were publicly filed in 2018 specifically prohibit the investors from buying or selling voting rights decoupled from the underlying securities.

Prohibitions on activists seeking extraordinary transactions not recommended by the board remain the norm but have declined over the past few years. Such provisions were found in 70% of agreements reviewed for 2018, down from 84% in 2017 and 96% across 2015 and 2016.

Additionally, there was a 22% decrease (from 94% in 2017 to 72% in 2018) in provisions prohibiting the activist from publicly seeking amendments or waivers from the standstill. The majority of agreements containing such a prohibition include an exception if such request is made privately to the company's directors or officers.

## **F. VOTING AGREEMENTS**

83% of the 2018 settlement agreements reviewed include a provision requiring the activists to vote their shares in a prescribed manner within the standstill period compared to 94% of settlement agreements in 2017. 7% of the settlement agreements simply require the activist to vote for all the director candidates nominated by the

board, and 2% of the settlement agreements require the activists to vote in accordance with all board recommendations. The remaining 74% of settlement agreements either specify proposals for which the activists must vote (such as ratification of the appointment of an auditor, “say-on-pay” proposals, proposals regarding equity incentive plans, specific transactions, etc.) or include exceptions permitting activists to vote in their own discretion on certain proposals.

One of the most common exceptions to the voting agreement provision is when a board recommendation differs from that of the proxy advisors ISS and/or Glass Lewis. This exception appears in 39% of settlement agreements reviewed for 2018, marking an upward trend from 26% in 2017 and 22% in the prior two years. This exception takes several forms. In some cases investors are permitted to vote against the board recommendation if either ISS or Glass Lewis makes a recommendation differing from that of the board with respect to a proposal, while other times both ISS and Glass Lewis must make such a differing recommendation. Some agreements also limit the exception to ISS recommendations only. Additionally, some agreements limit the ISS/Glass Lewis exception to only specified matters, such as “say-on-pay” proposals, requiring the investor to support most or all other board recommendations notwithstanding an ISS/Glass Lewis recommendation to the contrary.

Other exceptions include extraordinary transactions (e.g., mergers or liquidations), amendments to the company’s articles of incorporation, stock issuances and compensation plans.

<b><i>Voting Provisions</i></b>	<b><i>2018 Percentage</i></b>	<b><i>2017 Percentage</i></b>
All board recommendations	2%	10%
Specific board recommendations or exceptions	74%	68%
The board slate only	7%	16%
No voting provision	17%	6%
ISS/Glass Lewis exception to voting provision	39%	26%

## **G. EXPENSE REIMBURSEMENT**

52% of the settlement agreements reviewed for 2018 require the issuer to pay some portion of the activist’s expenses, with the remaining 48% either silent on the topic or expressly stating that each party shall pay for its own expenses. While the percentage of agreements providing for expense reimbursement in 2018 was consistent with 2017, the distribution of expense reimbursement caps changed. In

2018, there was a substantial increase in the percentage of settlements in which the company reimbursed expenses up to a cap of \$100,000 to \$500,000, up from 13% to 24%, and a corresponding decrease in the percentage of settlements with an expense reimbursement cap of \$500,000 or more, down from 16% to 7%. These changes bring 2018 back in line with reimbursement caps observed in 2015 and 2016 (22% and 6%, respectively). According to *Activist Insight Online*, the average settlement reimbursement amount in 2018 was up to \$431,831 from \$157,000 in 2017. *Activist Insight Online* attributes much of this increase to the higher number of reimbursements from mid-cap and large-cap companies, although this increase was also impacted by the presence of three multimillion-dollar reimbursements in 2018: (1) Newell Brands-Starboard (\$2 million cap); (2) Innovia-Sarissa Group (\$2.7 million cap) and (3) Wynn Resorts-Elaine Wynn (\$5 million cap). In comparison, 2017 settlements with expense reimbursement caps above \$500,000 or more largely had caps between \$500,000 and \$1,000,000.

Additionally, there were two settlements in 2018 requiring the issuer to reimburse expenses without disclosing a cap—one such agreement references an undisclosed cap privately agreed upon by the parties while the other provides for the reimbursement of “reasonable” fees.

<i>Expense Reimbursement</i>	<i>2018 Percentage</i>	<i>2017 Percentage</i>
Each party pays for its own expenses	48%	45%
Cap of less than \$100,000	17%	26%
Cap of \$100,000 to \$500,000	24%	13%
Cap of \$500,000 or more	7%	16%
Others (including no cap)	4%	0%

# 8 FUTURE AREAS OF STUDY

As much as activism has matured and there has been a proliferation of literature on the topic in the past couple of years, there are still a few areas that we think merit further study. These, however, are beyond the scope of our analysis as they require economic or statistical analysis or other data that is not readily available to us at this time.

## 1. The Correlation between Stock Drops and Activism

When clients ask how they can avoid having an activist come into their stock, we always tell them that they should focus on having good performance, high returns and a healthy stock price. This is easier said than done, of course. But we do think it would be very interesting to study the extent to which issuers' stock drops correlate with activism and, if they do correlate, what kinds of patterns emerge. Is a single quarter downturn sufficient to attract an activist or must the drop be sustained over multiple quarters? How far does the stock have to drop before an activist will become interested? Is an activist more likely to emerge following a significant one-time adverse event or a persistent operational or financial performance issue? Is the extent of the drop relative to peers a more relevant metric than an absolute drop?

## 2. ISS's and Glass Lewis's Influence in Activism Contests

There was continued discussion in 2018 about potential reforms that could impact the activism landscape, including universal ballots, 13D timing, the SEC's Proxy Roundtable and regulation of proxy advisors to name a few. The proxy advisor issue in particular has garnered a lot of attention in relation to activism in the past. Preliminary research suggests that passive investors are strongly aligned with ISS on management proposals.<sup>51</sup> One recent study of 713 institutional investors in 2017 found that proxy contests receive 73% more institutional investor support when ISS supports the measure and 64% more support when Glass Lewis supports the measure, but we have not identified any comprehensive studies addressing the true extent of the correlation between ISS recommendations and voting behaviors in activism contests. Moreover, much of the available data focuses on the voting records of the largest institutional investors, whose behaviors may not be representative of smaller funds who do not have in-house research departments and therefore may be more likely to rely on proxy advisor recommendations.

Another interesting area for further study would be to analyze the extent of any correlations between proxy advisor score card results and

<sup>51</sup> See Investment Company Institute, *Funds and Proxy Voting: Funds Vote Thoughtfully and Independently* (Nov. 7, 2018) (available at: <https://www.sec.gov/comments/4-725/4725-4702049-176465.pdf>).



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activism vulnerability. For example, are companies that have high ISS QualityScores more likely to enjoy a safe harbor from activists because the activists are forced to make economic arguments rather than governance arguments? This suggestion for further analysis presupposes that ISS and Glass Lewis are “leading indicators” of the latest waves of governance reforms, but in reality a better comparison might be to Council of Institutional Investor policies or to the voting guidelines of the largest index funds.

### 3. Activism as Export

Our study focuses entirely on activism directed at U.S. issuers, but much of the headline-grabbing 2018 activism actually targeted non-U.S. issuers.<sup>52</sup> One area for further study would be to try to assess whether the non-U.S. issuers targeted by activists have any common attributes – size, jurisdiction of formation, regulators, etc. Taking it a step further, it would also be very interesting to collect data to assess what strategies appeared to be most successful outside of the U.S. (both on the activist side and the issuer side). There are European activism studies available,<sup>53</sup> but until recently the number of data points were probably too limited to draw any definitive conclusions about statistical correlations.

\* \* \*

The 2018 activism landscape, which has been highlighted by a record number of first-time activists launching campaigns, increased success of activist nominees at obtaining board seats (largely through settlements) and an increased focus on M&A, suggests that activism will continue to be an important consideration for companies in 2019. Additional topics of activist and institutional investor focus, such as ESP and governance-related shareholder proposals, will be revisited in our 2019 Proxy Season Review.

\* \* \*

<sup>52</sup> In fact, a record 47% of publicly announced activist campaigns in 2018 targeted non-U.S. issuers. See Activist Insight, *The Activist Investing Annual Review 2019*.

<sup>53</sup> See, e.g., Activist Insight, *Activist Investing in Europe 2018*.

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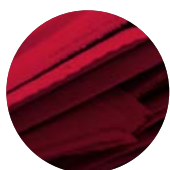
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