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# Impact of COVID-19 on Shareholder Activism and Unsolicited Offers

## Considerations for U.S. Public Companies


### SUMMARY

While public company boards and management are understandably focused on the unprecedented crisis affecting their employees, customers and communities, after these critical issues have been addressed, boards and management are likely to face a number of follow-on consequences of this crisis. COVID-19 has caused significant volatility in the equity markets, with companies across different industries experiencing declines—some precipitous—in share prices as well as significant changes in share ownership. Developments at many companies will likely attract the attention of shareholder activists. These potential targets include both companies that already have significant activist representation in their stocks, and those facing new vulnerabilities. In addition, the depressed equity values of these companies may also make them more vulnerable to unsolicited takeover offers. Among the challenges, we expect that boards and management may be called upon to:

- address short selling and vulnerability to unsolicited takeover bids;
- prepare for proxy contests, special meeting demands and written consent campaigns;
- prepare responses to activist demands;
- engage with institutional shareholders (and potentially regulators and other stakeholders) amidst the crisis; and
- respond to the changing legal and regulatory environment.


### OVERVIEW

As companies assess the effects of COVID-19 on their businesses, it will be important for directors and management to evaluate and prepare for the pandemic's impact—both in the short and long term—on the company's relationships with its shareholder base, including how the company would respond to a potential activist's or acquiror's demands. As a result of COVID-19, U.S. public companies may experience an uptick in these types of activities, as periods of exceptional turbulence in the equity markets are often accompanied by a rise in shareholder activism and unsolicited offers. For example, the 2008 financial crisis was followed by a significant increase in the number of unsolicited offers, proxy fights and event-driven investing.

For most U.S. public companies, the window for shareholders to submit a proposal for the company's 2020 annual general meeting has passed, mitigating to some extent the immediate risk of shareholder activism in the form of annual meeting proxy contests. However, activist proposals remain a more immediate risk for issuers that have (i) non-calendar year end fiscal years or (ii) an advance notice period tied to disclosure of the annual meeting date if they have not yet announced the date of an upcoming annual meeting. Even in the short term, companies may face risks related to short selling, unsolicited offers and general business disruption caused by private or public initiatives from activists. Activists may also engage in proxy fights through special meeting demands and written consent campaigns. To prepare for activism, companies should work closely with their internal and external advisors to plan for responding to actual or potential activist demands, including by engaging with institutional investors, regulators and other stakeholders, as well as monitoring changes in the legal and regulatory environment.

## SHORT SELLING AND UNSOLICITED TAKEOVER BIDS

In light of the recent market fluctuations, issuers may see an increase in short selling as investors attempt to capitalize on volatility in share prices. Some short sellers may take their activities one step further by publishing or leaking an investment thesis to support their short selling, which often accelerate declines in share prices. Companies need to monitor this risk (which may be difficult, as SEC rules do not mandate disclosure of a short position and also permit an activist short seller to close out a disclosed short position at any time after publication, even at a price different than the activist's stated valuation) and prepare relevant disclosures, so that they can swiftly rebut any misinformation that may be published by short sellers. An expeditious response in these situations is critical, especially as companies have very few if any other effective tools to respond to false or misleading public statements by activists.

Additionally, the COVID-19 crisis may leave companies more susceptible to unsolicited proposals. Declining share prices at many public companies may incentivize a rise in unsolicited proposals, as lower share prices decrease the cost of gaining an equity position in a company. Furthermore, due to uncertainty and potentially constrained alternative buyers, some companies may experience obstacles to a board-supported or negotiated strategic transaction, such as a merger, spin-off or securities offering, which may limit the number of viable options the board can present to shareholders as attractive alternatives to an unsolicited offer. Convincing shareholders that depressed share prices do not justify selling the company for less than its intrinsic value may be particularly challenging in a volatile environment. That task may be further exacerbated by changes in a company's shareholder base, as investors that have recently acquired shares at lower prices could be more receptive to an unsolicited offer that undervalues the company. Proactive steps a company can take include: (i) reviewing the company's projections and business plan with the board to ensure alignment on the company's prospects and intrinsic value and to promote cohesion amongst the members of the board and management, which is often critical to defending against an unsolicited offer; (ii) working with its financial advisors to identify alternate counterparties and strategies as well as to prepare to defend its stand-alone value plan if faced with an unsolicited bid; (iii) working with its proxy solicitor to monitor changes in its shareholder base; and (iv) discussing with its outside counsel the advisability of adopting additional takeover defenses (such as shareholder rights plans), in each case, so that its board can have the time necessary to fully and adequately consider and communicate with shareholders about the fairness of a bid for the company.

Taking these steps is particularly important when equity values are depressed because whether an antitrust filing is required under the Hart-Scott-Rodino Act ("HSR Act") is based on a dollar—and not percentage—threshold for the value of voting securities acquired. The current HSR threshold of $94 million is sufficiently high in relation to some companies' depressed stock prices that an activist may be able to accumulate a substantial stake without having to make an HSR Act filing. Therefore, unless the potential acquiror's or activist's stake surpasses 5% and a Schedule 13D filing is required, the company may not be on notice that its shares are being accumulated by an activist, and even if a Schedule 13D filing requirement is triggered, the potential acquiror or activist still has a 10-day window prior to disclosure of its position. Companies in regulated industries may also consider proactive engagement with regulators to address any increased risks of an unsolicited offer and any meaningful accumulation of its shares in an activist or hostile acquiror's hands.

## PROXY CONTEST, SPECIAL MEETINGS AND WRITTEN CONSENT

While most proxy contests to replace incumbent directors with an activist's slate are voted on at the annual shareholders meeting, activists may act opportunistically to undertake the additional costs and risks of conducting a proxy contest even when the annual meeting window has closed. Therefore, companies whose governing documents allow shareholders to call special meetings or act by written consent need to be cognizant of when shareholders are allowed to make proposals or nominate directors after the window closes for the annual meeting. Many companies' charter documents mandate blackout periods ranging from 90 to 120 days following their annual meeting, during which shareholders may not call a special meeting or act by written consent. These blackout periods provide management with an opportunity after the annual shareholder meeting to focus on operational issues and substantiate defensive strategies. Companies that have special meetings or written consent provisions should also review the scope of actions that are allowed to be taken at a special meeting or by written consent, including whether or not directors may be removed or elected. For example, some companies have special meeting provisions that would permit the company to exclude a shareholder requested action that was already substantially addressed at a shareholder meeting or within a specified period of time since the annual meeting.

## IMPACT ON ACTIVIST DEMANDS

Over the coming months, there may be an increase in activist demands that combine the activist's primary investment theses with criticism of management's COVID-19 preparedness and response. As and when management has time and resources available amidst the crisis, management should consider whether its public disclosures provide a cohesive narrative regarding company leadership's efforts to respond to and mitigate the crisis. Presenting a consistent, contemporaneous message to shareholders—one that is specific to the company and the challenges it is facing—will be essential to the success of a company's activism preparedness and will be more effective in gaining shareholder support than a retrospective version. Of course, as always, the company should be mindful of Regulation FD in its shareholder engagement. A compelling narrative may also help the company in its engagement with regulators, who may need additional assurances in these unprecedented and sensitive times for policymaking.

## STAKEHOLDER ACTIVISM

In preparing a narrative relating to COVID-19's impacts, companies should consider not only the impact on shareholder value, but also the ways in which the interests of other stakeholders may impact shareholder value. For most companies, shareholder value is linked closely with the welfare and safety of employees and the communities in which the company operates, as well as the sustainability of the company's supply chain and other relationships. Institutional Shareholder Services' ("ISS") recently published Climate Proxy Voting Guidelines illustrates this point by recommending case-by-case voting on shareholder proposals requesting reports on (i) the impact of health pandemics on companies based on their potential geographic exposure and (ii) support of their employees' healthcare through healthcare policies, benefits and access, as well as their donations to relevant healthcare providers. While ISS generally recommends a vote against shareholder proposals seeking the establishment, implementation and reporting on a standard of response to pandemics, it may recommend a vote in favor of those proposals if companies have significant operations in the affected markets and have not adopted policies and procedures comparable to industry peers.

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