
SHAREHOLDER ACTIVISM

Trends in Shareholder Activism

*By Melissa Sawyer, Lauren S. Boehmke
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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.¹

I. The 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

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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.² Index funds, however, have not as consistently voted against activists as once hoped.³

In our most recent annual proxy season memo, 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.⁴ 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.”⁵

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).

Both State Street and BlackRock, however, 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.” This behavior, however, 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,⁶ as compared to 40% of new S&P 500 directors in 2018.⁷ We are not aware of an index fund failing to support an activist merely because the activist publicly presented an all-male slate.⁸ 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.⁹ The largest index funds appear to have given the activists a pass on the lack of diversity in their slates.

It, however, 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 to improve capital allocation and ESP practices.¹⁰ 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.¹¹

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.¹² 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.

A recent article, however, reviewed a more civil style of activist tactics as “soft” activism, emphasizing the importance of behind-the-scenes engagement.¹³ 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).¹⁴ 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 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.¹⁵ 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.¹⁶ 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 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).¹⁷ 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.¹⁸

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)¹⁹ 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.²⁰

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.²¹

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 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.²² In January, Elliott asked investors for \$2 billion to pursue take-private transactions.²³ 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 outside 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 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.

II. The 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

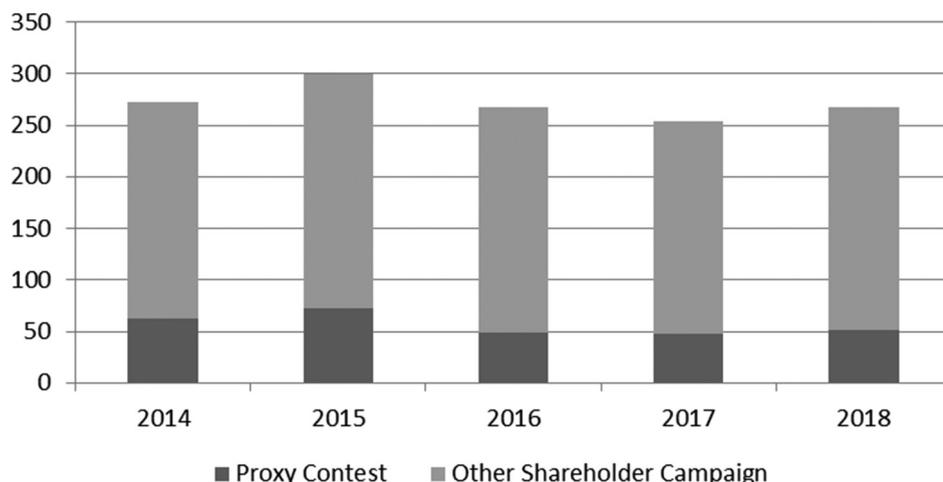
five years with an average of approximately 272 campaigns announced per year. The total number of public campaigns in a given year, however, does not paint a full picture; based on anecdotal information, a significant number of activist situations also are being resolved without publicity.

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.

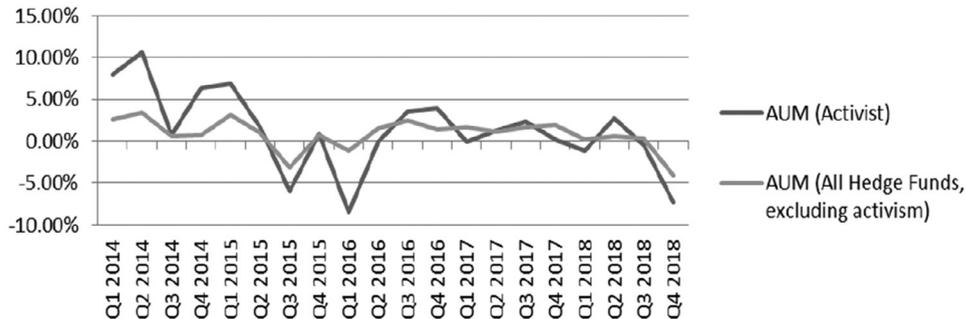
B. Assets under Management by Activist Hedge Funds

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.

Activist Campaign Totals



Percentage Change in AUM - Activist Hedge Funds versus All Hedge Funds



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.

Notes

1. See the entire study at <https://www.sullcrom.com/sandc-mna-2018-us-shareholder-activism-analysis>.
2. 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.
3. 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).
4. See <https://www.sullcrom.com/2018-proxy-season-review>.
5. See Larry Fink’s 2019 Letter to CEOs – Purpose & Profit (available at <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>).
6. See Lazard’s Shareholder Advisory Group, *2018 Review of Shareholder Activism*.
7. See Spencer Stuart, *2018 United States Spencer Stuart Board Index* (available at https://www.spencerstuart.com/medial2018/october/ssbi_2018.pdf).
8. 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 Preqin, *Women in Hedge Funds* (Feb. 2019).

9. 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/>).

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

11. 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).

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

13. 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/>).

14. See The Wall Street Journal, *Elliott Management Goes on Charm Offensive* (Oct. 8, 2018).

15. 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).

16. See Bloomberg, *Citigroup Agrees to Give Activist ValueAct Details on Strategy* (Jan. 11, 2019).

17. 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/>).

18. 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>).

19. See Russell Reynolds Associates, *2019 Global & Regional Corporate Governance Trends* (Dec. 11, 2018).

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

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

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

23. See Wall Street Journal, *Elliott Looks Beyond Activism to Full-Blown Takeovers* (Jan. 30, 2019).