The new regime

An interview with Ryan Nebel and Elizabeth Gonzalez-Sussman, vice-chairs of Olshan Frome Wolosky's shareholder activism practice group.

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Ryan Nebel
rnebel@olshanlaw.com

Elizabeth Gonzalez-Sussman
egonzalez@olshanlaw.com

What have we learned from the first universal proxy fights and how might the new regime impact the future of activism?

Elizabeth Gonzalez-Sussman (EG): The changes universal proxy brought on have been interesting to observe. We have a new voting regime where both incumbent and dissident directors will appear on one proxy card, assuming that the company recognizes an activist's nominations. One situation has already played out where a company took the position that the activist's nominations were invalid, so ran one card that didn't include the activist's nominations.

If we look at the first successful campaign to use universal proxy, our client Land & Buildings was able to secure one director appointment on AIMCo's board. This suggests what many predicted; that it may be easier to get minority representation, enabling shareholders to pick and choose the best board composition.

Under this new regime, I predict there will be more settlement offers earlier in a campaign's lifespan. Activists will have to decide whether to agree to a settlement for one board seat or whether it is worth taking their chances and running a full contest, which could potentially result in winning just one or two board seats, if not several more.

One consideration making campaigns more challenging for activists is that it's becoming increasingly difficult to secure that great nominee, and there are several reasons for this. Not everyone wants to serve on an activist's slate; there is no guarantee of success, and it is unpredictable how dissident nominees may be targeted by a company. One must also consider the many boxes a nominee has to check in relation to C-suite experience, industry experience, etc. Planning is crucial ahead of this new universal proxy regime.

Ryan Nebel (RN): It is important to remember that the activist still has to establish a case for change. Even if an activist has stellar board candidates, shareholders need to believe that change is warranted. Assuming the activist can hit that threshold, universal proxy does open up the playbook and make it far more difficult for companies to shield their weakest directors. On the flip side, boards could be encouraged to unilaterally refresh, seeking to take the wind out of an activist's sails ahead of the shareholder meeting.

More companies adopted aggressive defense tactics last year, including poison pills and burdensome bylaw amendments. Why was this and will this trend continue into 2023?

RN: The surge in poison pills was largely due to the number of companies that experienced depressed valuations in 2022. As a result, many companies recognized that this could make them vulnerable to a potential hostile bid or other activist engagement, and took action to attempt to mitigate the perceived risk.

With respect to bylaw amendments, in 2022 we saw several companies adopt aggressive changes to their advance notice provisions under the guise of conforming to the new universal proxy rules. Instead, these amendments often overhauled the company's nominating requirements, going far beyond any technical changes that may be required to account for the new rules. In fact, some new requirements seek invasive information on dissident shareholders and nominees that are entirely irrelevant to a candidate's qualifications or ability to serve on the board, which we find concerning. Until Masimo's bylaws, which are currently being contested in court, are struck down or abandoned, there is a potential risk that additional companies could seek to enact similar shareholder-unfriendly provisions. Directors should think twice before adopting any such changes though because it ultimately amounts to a thinly-veiled attempt to disenfranchise shareholders.

EG: Bylaw amendments are tricky to navigate because, in some cases, not all shareholders fully digest the extent to which these changes are impacting investors' abilities to hold boards accountable.

We penned an open letter to directors last year to be on the lookout for certain bylaw changes that are adopted under the guise of aligning with new universal proxy rules but are, in fact, being thrown in there as a barrier to entry for activists and making the cost of nominating skyrocket. This can especially disenfranchise shareholders at small- and micro-cap companies that don't have the same kinds of governance standards. Every director needs to really scrutinize what these bylaw amendments involve. Are they chilling shareholder engagement to an excessive extent?

How did activists' priorities and engagements change in 2022?

RN: There were, of course, more and more ESG-focused campaigns entering the fray last year. Looking at more traditional activists, we saw an increase in campaigns geared towards operational and management changes. We ran several campaigns focused on CEO and leadership changes, and this likely contributed to why we didn't see as many early-stage settlements in the first half of the year, prior to the introduction of the universal proxy. We also had quite a few clients launch control fights last year. Many believe that control fights may become even more difficult to win under the universal proxy regime, so several activists took one last bite at the apple in the first half of 2022 with majority slates.

EG: In the control fights we were involved with, there was certainly a motivation on the part of the activists to make sure they made their viewpoints and goals clear before financial markets began to chill. Everyone knew that the Federal Reserve would increase interest rates multiple times last year so there was a race to complete any strategic initiatives before that happened. Nominating control slates were often the tactic activists employed to hold companies' feet to the fire. Going forward, I think we will see fewer control slates, given where markets are and the impact of universal proxy.

Given rising interest rates and market volatility, could M&A and capital allocation activism see a significant shake-up in 2023?

EG: Rising interest rates can certainly impact the ability of buyers to finance an acquisition. A company's liquidity also suffers in the event of rising interest rates, making a company more distressed. What I am seeing is that more companies are focusing more on improving their operations to weather the storm, so to speak. Issuers may be unable to sell their struggling subsidiaries or holdings but pivot their focus on how to best position the company to better perform. Companies will likely refocus on holding management to account for underperformance, as well as spend more time analyzing cost-cutting measures and capital allocation. ■