

# KIRKLAND M&A UPDATE

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## Shareholder Activism — Evolving Tactics

*Companies should be aware of evolving activist tactics and be prepared for new approaches.*

Shareholder activist tactics are evolving as hedge funds deploy capital in a market where much of the low-hanging fruit has been plucked and target companies are more aware and better defended against traditional strategies. New approaches are also being deployed by first-time and infrequent activists who don't always operate from the typical activist playbook. Companies should be aware of these strategy shifts and be prepared to be flexible in defending against new and novel approaches:

**More demands for board control.** Not satisfied with a “short slate” of one or two board seats, more activists are demanding board control, including by nominating a full slate of replacement directors. Control contests are harder for activists to win, but success also comes with a higher payoff: rather than just being a voice in the boardroom, control gives the activist the ability to more rapidly implement an agenda (e.g., Xerox terminated its deal with Fuji as part of its settlement giving control to Icahn and Deason). Activists are also using the threat of a contest for board control as a bargaining chip to extract better “short slate” settlement terms, safe in the knowledge that the activist retains the option to cut back its nominations to a minority slate during the course of the proxy contest. While this gambit risks undermining an activist's credibility with shareholders and proxy advisory firms, we expect to see it used more, particularly by less experienced funds.

**No longer “all clear” after nomination deadline.** The “safety” of the director nomination deadline isn't what it used to be. Even after missing a nomination deadline ahead of the annual meeting, activists are increasingly waging “withhold” campaigns targeted at one or more directors in an effort to register their displeasure, often in response to events taking place after the nomination deadline (e.g., Land and Buildings launched a campaign against QTS Realty after the post-nomination deadline announcement of a change in corporate strategy led to a large stock drop). The prospect of a large “withhold” vote against a sitting director can pressure that director to resign or the board to consider a settlement with the activist. And as we have [noted before](#), activists recently succeeded in convincing a court to force a company to reopen its nomination window because of material events that took place after the deadline. We are seeing other activists privately threatening to bring similar pressure as a way of extending the period during which a company is vulnerable to demands for a settlement or contest. We expect activists to continue to use these and other “off cycle” pressure tactics, particularly following post-nomination deadline announcements of major transactions, large earnings misses, financial restatements, or scandal-driven management exits.

**Activism across the capital structure.** With the multitude of securities and undisclosed derivatives available for investment and hedging up and down the capitalization structure, activists are increasingly using various entry points to deploy activist measures in situations where their true economic motivations may not be evident. For example, debtholders with economic positions designed to profit from a default in a company's debt (i.e., through credit default swaps) are more frequently threatening to assert a default directly. Strategies include raising the possibility of tripping the change of control covenants by buying up large equity stakes on the cheap, acquiring a position sufficient to block a shareholder vote for a transaction necessary to stave off insolvency, or, as Aurelius is pursuing at Windstream, formally asserting a technical covenant default on a transaction approved and consummated years ago. While the CFTC has publicly suggested that other strategies involving a company and creditor “manufacturing” a default designed to trigger credit default swap payments to the creditor may constitute market manipulation, we expect continued creativity from activist investors seeking to profit from their varied and hedged debt and equity positions.

**The growing impact of ESG.** As ESG principles continue to grow as a focal point for passive institutional investors, the fastest growing segment of the shareholder base, activists are more prominently incorporating ESG-

related demands into the messaging and platforms of their campaigns. Some activists have made governance issues the singular focus of their public campaigns even if their overall goals may be broader (e.g., Glenview’s push for the shareholder written consent right at Tenet), while others have gone as far as launching dedicated ESG activist funds (e.g., Jana is raising a new ESG-focused fund and partnered with CalSTRS in pushing Apple to address iPhone parental controls). As passive funds increasingly play the role of the “swing vote” in contested elections, we expect ESG matters to figure more prominently in both activist campaigns and regular way investor engagement.

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If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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