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Shareholder Activism – Lessons from Huntsman’s Proxy Fight Victory Over Starboard

- » Huntsman’s recent proxy contest against Starboard marked the first time in seven years that a company achieved a complete victory at the ballot box against a prominent activist hedge fund without ISS support.
- » As the SEC’s new universal proxy regime increases leverage for activist investors, companies should carefully study the strategies and tactics that have been effective in winning proxy contests and improving leverage in settlement negotiations.

The SEC’s new universal proxy regime takes effect in September 2022, dramatically reducing the cost of admission for activists to run proxy contests. This shift is likely to have significant implications, including (1) activists launching more campaigns, particularly by first-time and non-traditional activists, (2) activists nominating more candidates in each campaign, and (3) activists more frequently obtaining at least some board representation. As the new regime increases leverage for activist investors, companies should carefully study the strategies and tactics that have been effective in winning proxy contests and improving leverage in settlement negotiations.

In September 2021, Starboard Value, one of the most prolific activist hedge funds, launched a proxy fight seeking to replace members of the board of directors of our client, Huntsman Corporation. After six months of engagement and a contentious public campaign, Huntsman prevailed at the ballot box, with its shareholders rejecting each of Starboard’s four nominees by at least a 10% margin. Huntsman’s victory marked a rare example where a company successfully prevented a prominent activist hedge fund from winning at least one seat in a proxy fight that went the distance. The win was particularly notable because it was achieved without ISS support.

While each activist engagement is different, we outline below a few lessons from Huntsman’s preparation and response to this contest that companies may wish to consider when facing an activist:

- **Reset the Burden of Proof: From “What’s the Harm?” to “Is there a Compelling Case for Change?”** Activists look to convince investors of a very low bar for supporting dissident candidates, arguing that the relevant question for shareholders is simply, “What’s the harm?” of adding one or more directors suggested by the activist. Activists will continue to emphasize this approach under the new universal proxy regime, which may further enable activists to focus on the identity of specific dissident candidates over any particular value-creating strategy being offered by the activist. Companies should refocus investors and proxy advisers on the more relevant question, which also constitutes the first prong of ISS’s analytical framework for proxy fight recommendations: “Has the activist made a compelling case that change is warranted?” While Starboard touted the industry qualifications of one of its candidates and made the argument that there was no downside to adding him to the board, Huntsman and its board of directors succeeded by reframing the debate around their argument that further board change was not needed in light of the substantial progress made under the oversight of a recently and intentionally refreshed board. In doing so, Huntsman successfully emphasized that its incumbent directors were highly qualified with uniquely valuable skillsets that would be lost if the dissident’s candidates were elected.
- **Don’t Give Up on Self-Help.** Activists regularly try to characterize positive changes made by a company after an activist appears on the scene as “reactive” in an effort to take credit for corporate governance and strategy enhancements as

well as any related stock appreciation. While this tactic sometimes resonates with proxy advisers, it shouldn't discourage companies from both (1) continuing to execute on long-standing plans and ensuring that the market understands that these actions were consistent with these plans and (2) taking additional incremental actions to demonstrate their openness to considering other pathways to generating long-term shareholder value. From the end of 2017 through its 2022 annual meeting, Huntsman added eight new independent directors, six incumbent directors retired and Huntsman appointed a new lead independent director and new chairs for each of its standing committees. Following Starboard's campaign launch but consistent with its long-term strategy, Huntsman also announced ambitious long-term financial targets, a review of strategic alternatives for one of its businesses and a new executive compensation plan aligned with achieving its newly announced targets. While Starboard argued that its presence prompted these changes, Huntsman succeeded in convincing more investors that these enhancements were consistent with its previously articulated long-term strategy.

- **Challenge Conventional Wisdom.** While companies facing activist investors appropriately look to precedent situations as a reference, they should not allow themselves to rely upon largely recycled responses and tactics from prior cycles. Companies should question all preconceived notions of how activist engagements are "supposed to play out" and focus instead on taking actions that they believe are in the best long-term interests of shareholders, even if there is a risk that they could be perceived negatively by activists or governance-focused institutions. For example, when it became clear after negotiations that a costly and time-consuming proxy fight was inevitable, Huntsman's board acted decisively to schedule the date of its 2022 annual meeting to allow the shareholders to decide the outcome as expeditiously as possible, a move that triggered an alternative director nomination deadline under its bylaws. While Starboard sought to paint this action negatively, these arguments ultimately did not resonate with investors, and the expedited resolution saved Huntsman and its shareholders months of additional distraction and costs.
- **Investor Communications: Quality > Quantity.** Like good consumers of any form of persuasive communication, investors making decisions in proxy fights prize quality over quantity, and unnecessarily long and repetitive materials tend to get ignored. Just because an activist puts forward a laundry list of criticisms, the company should not feel compelled to rebut every point or match the sheer volume of pages. Huntsman focused on publishing comparatively concise materials that highlighted the company's progress, trajectory and nominee qualifications.
- **Independent Director Participation Can Be Critical.** When engaging with companies under activist attack, institutional investors will often want to meet independent directors to ascertain whether the board can articulate the business strategy and ESG objectives outlined in the published fight materials and is capable of holding management accountable. Several of Huntsman's independent directors took important roles in investor meetings and played a part in winning support of large institutions. The fact that some directors had previously participated in the company's investor engagement on both ESG and strategic issues further enhanced their credibility.
- **ISS: Typically Sufficient But Not Always Necessary.** In contested situations, ISS typically influences 15% to 40% of the vote and commonly supports activists. Accordingly, companies under attack rightfully focus on winning recommendations from ISS and the other major proxy adviser, Glass Lewis. While securing ISS support is often sufficient to defeat an activist campaign, it is not always necessary. Ultimately shareholders are the ones who cast votes. ISS recommended voting for two of Starboard's nominees, but Huntsman was able to defeat all four by winning the support of both Glass Lewis and a large percentage of its passive and active holders.
- **Performance is Ultimately the Best Defense.** When a company is armed with a credible strategy and a board that is overseeing sound execution, shareholders can be convinced that the company is on the right path and will be reluctant to support an activist campaign that threatens to disrupt the momentum. During the six months following Starboard's 13D filing in September 2021, Huntsman continued to execute on its long-term strategy, delivering record full-year results in 2021 and issuing Q1 2022 guidance above consensus (and later raising guidance). By demonstrating discernable progress on its financial targets, Huntsman was able to reorient the discussion to the present rather than debate historical performance.
- **When a Brand Name Activist Shows Up, Settlement is Not the Only Option.** While every situation is unique, companies should keep in mind that high-profile activists do not always win proxy fights and are not always prepared to go the distance. In determining whether to pursue a settlement or take the contest to a vote, companies should undertake a candid analysis of whether the activist has quality ideas and additive director candidates. When there's a clear vision forward and the right team in the boardroom, companies should not shy away from having their shareholders decide the outcome. At Huntsman, the activist campaign seemed to be targeting the Huntsman of 2012 rather than the Huntsman of 2022. Unable to reconcile Starboard's platform and nominees with Huntsman's clearly articulated go-forward strategy and after early settlement negotiations broke down, Huntsman's board and management team resolved to go through with a proxy fight to protect the progress and momentum in the business. The results of the shareholder vote proved the board's instincts were right.

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

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