

4 Tips For Staving Off A Second-Bite Proxy Contest

By Karlee Weinmann

Law360, New York (December 05, 2013, 4:13 PM ET) -- A recent surge in shareholder activism was punctuated by a landmark 2013 proxy season with bigger-than-ever targets and tougher tactics that left boards scrambling. But as companies sharpen their focus on the coming year, experts suggest they stay vigilant to avoid second-bite plays from familiar faces.

Companies are increasingly finding themselves in second-bite proxy contests, winding up in an activist's crosshairs again. Most frequently, it's the same rebel shareholder that strikes twice, but sometimes new players emerge to launch the second proxy battle.

With a continued uptick in activism expected to carry the investment strategy to unprecedented prevalence again in 2014, attorneys said companies should be fully prepared to take on displeased stockholders angling for shakeups.

But that doesn't always translate to simply ceding a board seat or two to an activist to skirt a costly — and often public — battle for control, said Morrison Foerster LLP partner Spencer Klein, who also heads the firm's M&A practice and has written about second-bite fights.

"In many cases, that's a perfectly sensible answer, but in other cases, it's not," he said. "Companies need to understand that just because they settle doesn't mean they can avoid the fight in the future. They may just be kicking the can down the road."

Here, experts share four strategies to avoid second-bite proxy contests.

Take activists seriously from the get-go.

Companies' top brass should pay attention to activists from the time they start pushing for changes, attorneys said. And that should stick even after parties hammer out settlements — even deals that carry standstill provisions that prevent dissident shareholders from taking further action for a set period of time.

Most standstill clauses extend for a one-year term, after which activists can revive their criticisms if company leadership does not adequately address them in the first place, said Mario Ponce of Simpson Thacher & Bartlett LLP, who defends companies from attacks.

"Using a limited-duration standstill as a rope-a-dope strategy against an activist may not be effective

unless the company can implement strategic changes or operational improvements quickly, within the term of the standstill,” he said.

View the settlement as a beginning, not an end.

While it can be a slog hashing out settlement details, reaching such an agreement should not be celebrated as the end of a company's back-and-forth with a dissident investor — instead, it should be considered the foundation of a new shareholder relationship, Klein said.

Frequently, the leadership at targeted companies agrees to sign over board seats to vocal investors who have sketched out plans for strategic or operational change. Appointing activist affiliates to a governance body is a definite show of cooperation, but attorneys said the arrangement must be more than a cosmetic fix.

“These are sophisticated, thoughtful, well-capitalized, experienced and aggressive investors who show up at the company in the first place because they see some opportunity,” Klein said. “The opportunity from their perspective is to somehow create value for themselves and the investors in their funds. Their goal is not to sit on boards.”

To minimize the risk of a second-bite contest, a targeted company's top brass should give fair consideration to the alternatives proposed by an activist, adequately weigh the options for implementing such changes, and keep communication channels open, Ponce said.

Prioritize public relations.

How companies frame their interactions with an activist — settlements, in particular — influences how other shareholders, and the marketplace in general, perceive the outcome of a proxy fight. Without touting such a deal as a win-win collaboration aimed at creating value for investors, appeasing the activist and boosting the company, a target runs the risk of continued needling from unhappy shareholders.

“A company should be careful to have the spin be that this is something positive going forward, to put the uncertainty behind them, to have the benefit of the perspective and views of the activist designee on the board and the focus on enhancing shareholder value,” Ponce said.

Additionally, attorneys pointed to the settlement agreement itself as a tool for guiding the flow of information. The document should prohibit the activist from issuing public comment on the deal that contradicts or deviates from the joint announcement.

Going a step further, companies can restrict how much activist board designees can reveal about closed-door meetings. Stemming the outflow of information can prevent other potential activists from pouncing on the company, and head off backlash from other stockholders.

“I would advise companies to take a look at their corporate governance guidelines, particularly the confidentiality provisions, and make sure that they cover not only true material nonpublic information but also board deliberations,” said Skadden Arps Slate Meagher & Flom LLP partner Richard Grossman, who defends companies.

Get familiar with other shareholders.

Institutional investors virtually across the board are paying close attention to activist shareholders as the strategy goes mainstream. Especially in the face of a proxy fight, it's crucial for company leadership to understand the views and priorities of its biggest backers.

If an activist lobbies for more substantial changes, like a sale or unit spinoffs, knowing the stances of other major investors is key. If they agree with the activist proposal, it gives the company more leeway to work out a settlement that appeases all parties.

If they don't, the company has more leverage to work around calls for change — a benefit that can extend to potential activist approaches in the future, including second bites.

“It's very important that you've reached out to the shareholder base and confirmed that they're in concurrence,” Grossman said. “Companies that have properly designed investor outreach programs are going to have a sense of their institutional base and what they think makes sense.”

--Editing by John Quinn and Philip Shea.

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