

# PROXY FIGHTS

2020



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### INTRODUCING INSIGHTIA

In October 2020, Activist Insight merged with sister company Proxy Insight to form Insightia, a new leader in public company information. As a specialist in proxy voting data, Proxy Insight's expertise is highly complementary to Activist Insight's data on activist investing and corporate governance.

We hope you get a glimpse of our potential from this report, our first formal collaboration and a harbinger of greater things to come. Please do get in touch with a member of our team if you'd like to learn more.

#### Josh Black, Editor-in-Chief, Insightia

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### NOTES ON DATA

Data refer to U.S.-based companies only and are accurate as of September 1, 2020, unless otherwise noted.

Proxy contests are defined by *Activist Insight Online* as situations where activist shareholder nominees are initially publicly rejected by target companies, even if settlements are subsequently reached.

### ACTIVIST FOCUS TYPES

**Primary focus:** a fund or individual which dedicates most, if not all of its assets to activist positions.

**Partial focus:** a fund or individual which often employs activist tactics yet also uses other investment strategies.

**Occasional focus:** a fund or individual that adopts an activist stance on an infrequent basis.

**Engagement focus:** typically large institutions and individuals that rally for change to promote good corporate governance.

**Concerned shareholders:** an individual or group of individuals who collectively attempt to enforce change, typically in a 'one-off' situation.

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# ▶ THE BASIS OF ALL ACTIVISM

Proxy fights are an expression of the implicit threat activists rely on to enact change. But their professionalization in recent years has allowed them to be a battle of ideas, not just power, writes Josh Black.

Among the panoply of shareholder rights accepted across most public markets, few are as fundamental, or as fun, as the right to nominate and vote on the board of directors.

Shareholder proposals, which have generated considerable fuss in recent years, are often limited in their purview and nonbinding in nature. Litigation, while certainly not toothless, can be arcane and seemingly endless. So long as they exercise their fiduciary duties, directors can exercise their own judgement on most areas of their business.

## A COMMON MISTAKE

Proxy contests are a display of raw power, as well as intricate strategy. But it is worth remembering that they are the thin end of the wedge; of the roughly 450 U.S. companies publicly subjected to activist demands each year, just over 12% include a proxy fight for board representation and only 28% of all demands for board representation end up in a proxy contest.

Since 2014, *Activist Insight Online* data show that the number of demands for board representation where management where management rejects the activist's nominees publicly – our definition of a proxy fight, since not all go the distance to a vote or to filing of definitive proxy statements – has ranged from 44 to 69 between 2014 and 2019 in the U.S. Typically, somewhere around 22 go to a vote, although the number dipped to 17 last year. As this report makes clear, they are often a last resort, or the result of a mismatch in how activists and management teams judge their chances of success.

“Things settle when both sides have a similar estimation of the likely outcome,” Spotlight Advisors Founder Greg Taxin told Activist Insight in an interview. “If everyone can agree that the company is going to lose, you want to save yourself the time and distraction of the fight.”

Indeed, data suggest that the odds of winning a proxy contest are finely balanced. Of the 147 fights that went to a vote since the beginning of 2014, 70 were won by management and activists won at least one seat at 77.

## “Things settle when both sides have a similar estimation of the likely outcome.”

Chris Young, global head of contested situations at investment bank Jefferies and between 2004 and 2010 the specialist on proxy fights at Institutional Shareholder Services (ISS), says that in the early days of activism, “People questioned whether activism was a fad, and each time new ground appeared to be broken, such as Trian’s big win at the vote against large-cap Heinz in 2006, market participants were shocked, or hopeful that the changes were temporary.”

Yet, proxy fights persist. Egos, reputations, movable shareholder bases, and difficult calculations based on limited information all play their part in the transformation of a suggestion to improve shareholder value into a pitched battle. Proxy fights have never gone out of style, but they have changed.

### HOW TO MAKE FRIENDS AND INFLUENCE SHAREHOLDERS

If the outcome of a proxy contest remains uncertain, the professionalization and growing experience of activism has led to a set of narrow rules about how contests are waged.

Articles later in this report cover defense tactics and how slates are composed to maximize each sides’ chance of success.

Institutional stewardship teams growing in size and power have concentrated influence in the hands of methodical decision makers, many of whom take a long view on shareholder value. And the importance of proxy voting advisers has led to arguments tailored to their taste. The market leaders, ISS and Glass Lewis, evaluate each vote based on its individual merits but ask whether change is justified, whether the activist’s nominees are equipped to deliver it – and, in the case of a majority slate, whether the activist has a plan to improve the company. Arguments are often formulaic, but each side seeks to demonstrate a deeper understanding of the company’s predicament.

“Activists continue to face a higher burden when they seek to run a control slate,” notes Young. “Control slates succeed at companies that are not just underperforming, but where shareholders have lost confidence in the company’s board as a whole, which usually involves some egregious corporate governance failure above and beyond underperforming the peers or a lazy balance sheet.”

### IT HAPPENS

Tactics range across proxy contests, depending on the degree of change an activist believes is necessary, and what concessions a board is willing to make. Whether because of urgency on the part of the activist or because they cause management to dig in, M&A demands are often concurrent with proxy contests. Since 2014, 92 U.S. proxy fights saw an M&A-related activist demand six months before or after board seats were sought, compared with 64 for balance-sheet demands or 46 for operational demands.

Earlier this year, Senator Investment Group requisitioned a special meeting of CoreLogic shareholders to propose a majority board slate as part of its joint bid to acquire the company. However, that contest is temporarily an outlier. M&A-related proxy contests fell to a six-year low in 2020 due to the impact of the COVID-19 pandemic. Balance sheet-related

## Mid and large cap proxy contests



Percentage of proxy contests waged at U.S.-based companies with a market cap over \$2 billion by year, as a proportion of all proxy contests. 2020 YTD is as of September 1. Source: Activist Insight Online

contests rose to their highest in three years, as the conservation of cash became a key area of disagreement.

Few control slates or demands for CEO change settle early, although Paul Hilal's Mantle Ridge has managed the trick at CSX and Aramark. Indeed, Starboard Value fought its first proxy contest since 2014 this year, for a near-full board sweep at GCP Applied Technologies. Previously, its replacement of the entire board of Darden Restaurants had served as a warning, leading to a heap of settlements.

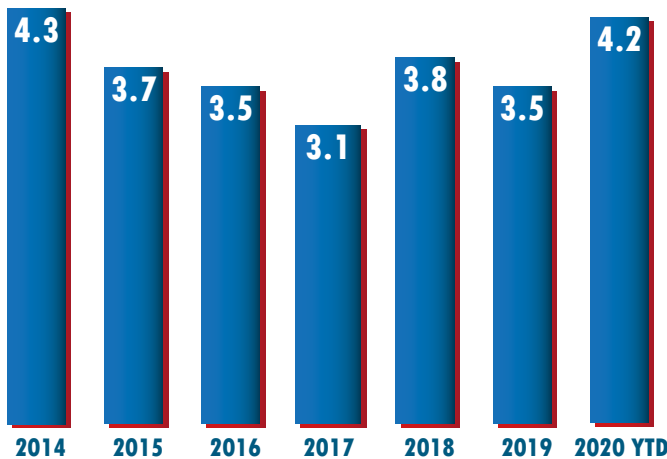
**“Proxy contests are a display of raw power, as well as intricate strategy.”**

### THE FUTURE OF PROXY CONTESTS

Thanks to carefully calibrated arguments and demands, proxy fights are no longer the lion's share of activism or even that common for specialist funds (as we illustrate in another article for this report). “More experienced activists have been trying to soften their initial outreach,” Moelis & Co.'s Duncan Herrington said in an interview. “Five or six years ago, they wouldn't even approach the company privately before publishing a letter or white paper... Now, they'd rather avoid a public fight if possible and will often approach well before the annual meeting calendar. But it's always understood that the stick is there too.”

Defense advisers say small or new activists seeking to make a name for themselves is a common factor in fights that seem impervious to an amicable resolution. Certainly, just 16% of U.S. proxy fights since 2014 have taken place at large- or mid-cap companies. But every so often, household name activists

### Seats sought at proxy contests



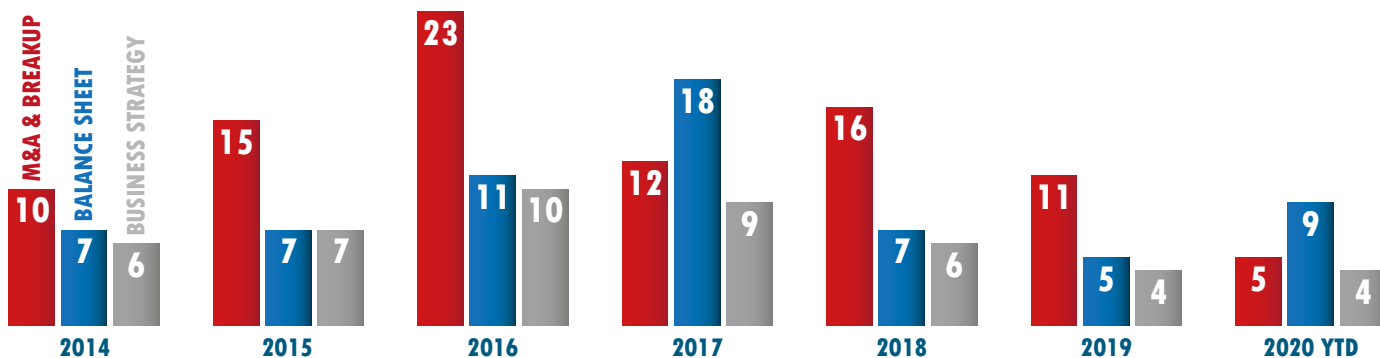
Average number of board seats sought by activists at U.S.-based proxy contests by year. 2020 YTD is as of September 1. Source: Activist Insight Online

identify a company where the opportunity is just too good, or the change required just too great.

In 2017, Pershing Square Capital Management, Trian Partners, and Elliott Management all fought proxy contests. Although none has fought one since, disavowing proxy contests has rarely been a useful strategy for an activist. This year, Hudson Executive Capital reversed a policy it had held since its formation in order to replace most directors at USA Technology.

The need for even the biggest activists to remain game ready, as well as the proliferation of specialist advisers and growing expertise of legal, shareholder engagement, and communications advisers means that proxy fights will not be solely limited to scrappy affairs led by newcomers, or even that the activist win rate will go into a terminal decline. Certainly, trends will ebb and flow but the proxy fight has a future, and its future isn't all that terrifying – until you're in one. 🇺🇸

### Proxy contests with contemporaneous campaigns



Number of U.S.-based proxy contests with M&A & breakup, balance sheet, or business strategy demands started within the six months before or after the demand for board representation. 2020 YTD is as of September 1. Source: Activist Insight Online



# A ROAD MAP FOR SUCCESS

Finding your way in a proxy contest is a matter of preparation and vigilance, write Lawrence Elbaum and Patrick Gadson, co-chairs of Vinson & Elkins' shareholder activism practice.

## SHOULD ISSUERS FEAR THAT ANY ENGAGEMENT ACTIVIST COULD LEAD TO A PROXY CONTEST?

Activists are not boogeymen — they are shareholders. So, companies should not be afraid of them. What companies should be afraid of is the unholy trinity of circumstances that set the table for the arrival of activism: poor operational strategy, poor financial performance, and poor corporate governance. If the fear is to be useful at all, it is only to the extent that such fear keeps management hyper-vigilant and focused on performance across measurables.

## HOW CAN COMPANIES BEST PREPARE FOR/RESPOND TO THE NOMINATION OF A DISSIDENT SLATE?

With respect to preparation, rule number one is “terrain drives strategy.” If you don't know the jungle, there is a good chance you're going to die in it.

In preparation for receipt of dissident nominations, governance documents (i.e., bylaws and charter) and the shareholder base are the terrain. The bylaws and charter tell a company its what, when, and whys/ifs: what form the nomination materials must be in, when an activist must deliver nomination materials, if directors can be removed outside of the annual meeting context, etc.

It is prudent to regard your shareholder base as your topography. Ultimately, the individual interests that drive shareholders, and the company's relationship with them, can make or break a contest. If companies ignore their shareholders, the contest is over before it has started. Companies should know the real-time thoughts and concerns of their shareholders.

As for the second question — responding to a nomination notice — this answer is easy: hire Vinson & Elkins.

## SHOULD COMPANIES TAKE THE HIGH ROAD, WHATEVER AN ACTIVIST DOES?

No. While companies are generally expected to take the high road and to refrain from ad hominem attacks, there are certainly times where it behooves boards to respond aggressively or even to instigate proactive communication to shareholders. For example, companies must develop a plan to respond directly to each of an activist's criticisms about business performance and the bona fides of board members and management. Oftentimes, such criticisms are meritless

and companies should make this clear in a swift, direct, and deliberate fashion. As another example, certain activists have a tendency to spin false narratives about a board's willingness to engage with shareholders. Indeed, if there's a good story for the board to tell about constructive engagement, it is critical for companies to expeditiously and decisively correct groundless activist timelines by pointing to facts to discredit activists and calling them out for being untruthful. If companies do not respond with strength and conviction in such circumstances, they could appear weak in the eyes of shareholders, as well as Institutional Shareholder Services (ISS) and Glass Lewis, whose support will be critical to achieve a successful outcome.

## DOES A CONTROL SLATE CHANGE HOW AN ISSUER SHOULD HANDLE A PROXY FIGHT?

If by “handle” you mean the level of seriousness companies should have in a proxy fight, then the answer is no. Control fights generally increase the level of complexity in everything from employee morale to disclosure but the gravity with which a company considers a proxy fight is not dependent on how many seats an activist is trying to win. Whether it is a single seat or all of the seats, the level of significance given to the fight should not change. The seriousness should be absolute — no exceptions.

Now, the tactics companies employ in response to proxy fights certainly change when they face a control slate, especially for those companies whose shareholder base is highly sensitive to proxy voting adviser recommendations. Since proxy advisers use a different analysis when evaluating a control-fight, companies must be aware of this and stage the sequencing of the delivery of their narratives accordingly.

More generally, there is no “what's the harm” consideration for activists in a control-fight; the harm could be total and complete. Everything is on the line — so when it comes to tactics, everything is on the table. 🇺🇸



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# PROXY FIGHTS FOR ALL

Once the privilege of a small group of established activist investors, the proxy fight is now a tool for all investors to catalyze change at their portfolio companies, writes Iuri Struta.

As activism in the U.S. has continued to professionalize, dedicated funds have increasingly settled out of the limelight while occasional activists launched ever-more proxy contests.

Starboard Value, one of the most prolific U.S. activists, has gained board seats at more than 27 U.S. companies since 2014, but only two demands went to a vote during that period, both of them victorious full board sweeps. Elliott Management has won board seats at 25 U.S. companies since 2014, with Arconic the only one to test its resolve – and even that company settled a few days before the vote.

To be sure, some activists like Starboard and Land & Buildings continue to launch a relatively high number of proxy fights, but these rarely reach a vote nowadays.

## UNPREDICTABLE

Occasional activists have picked up the slack. In 2014, around 74% of proxy contests in the U.S. involved professional activists, with a large part of them going the distance. In 2019, that trend reversed, with dedicated funds involved with 17 proxy contests (six went to vote) versus 29 (11 of them going to a vote) by investors that do not regularly use activism as a strategy.

**“The professional activist does a pretty good job of assessing chances, and companies recognize that.”**

Although costly, a proxy fight is often a reputational issue for activists. “There is more pressure on first-timers to take credit for any incremental changes that are made at the company because they need to establish a track record that can help them with fundraising and subsequent engagement,” René Soto, a founding partner at communications firm Reevemark, said.

Companies may also be more likely to settle with professional activists, as they already have a reputation among institutional investors, managements, and advisers, while their theses are often better prepared. “Occasional activist investors are more often hard to predict in terms of how they are going to engage.

With dedicated activists, you know what to expect,” Mark Mikullitz, head of shareholder activism at boutique investment bank Houlihan Lokey, said.

**“Strong allegations can often make it harder to settle.”**

## EXPERIENCE MATTERS


“The professional activist does a pretty good job of assessing chances, and companies recognize that,” Greg Taxin, the founder of Spotlight Advisors, a strategist for companies and investors, said in an interview for this report. “When someone brand new shows up ... that could lead to an assessment of likely chances of success that could differ.”

Another reason for the large number of settlements with dedicated activists is the quality of board slates. “The established activists have mastered this idea of quality nominees with the right backgrounds – something that not all newcomers have figured out,” Reevemark’s founding partner Paul Caminiti noted.

Advisers interviewed for this report also said dedicated activists have learnt how to serve public criticism in order to increase the chances of a settlement. Occasional activists could be more inclined to attack managements and make fights personal. “Strong allegations can often make it harder to settle,” Mikullitz said.

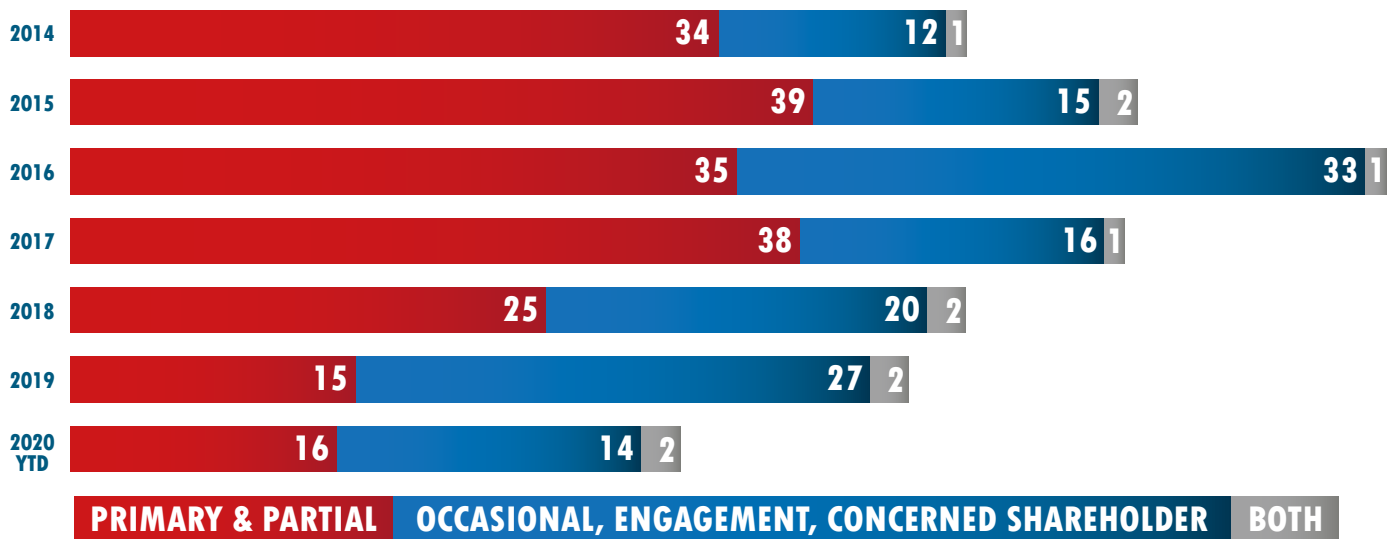
## UNIVERSAL TACTIC

This trend is unlikely to reverse. Ordinary investors are increasingly becoming more vociferous with underperformers in their portfolios. “Every fund manager will have the occasion to use this tactic,” Taxin said.

However, few first-timers will take the leap to become full-time activists, because a portfolio filled with activist positions is vulnerable to market downturns, according to Taxin. Dedicated activists, meanwhile, will continue to reach settlements, although occasionally they could be forced to show their might. 

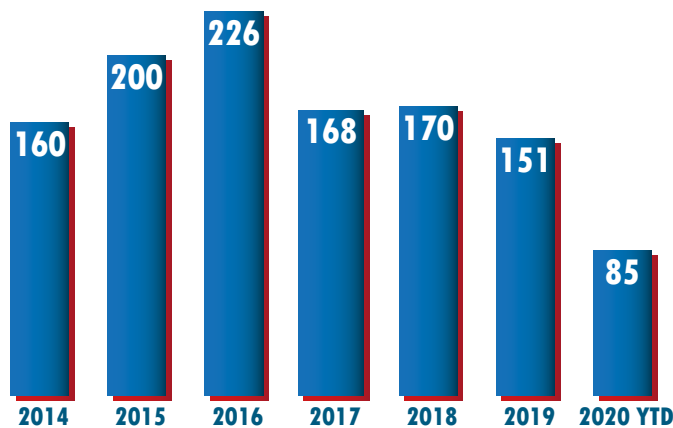


## Proxy contests resolved by year and activist focus type



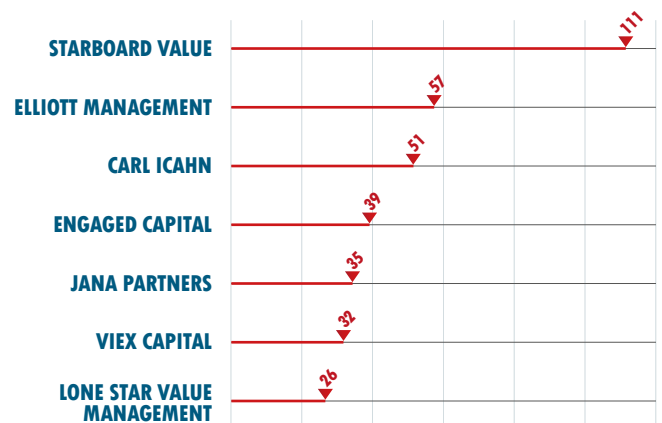
Number of proxy contests resolved in each year at U.S.-based companies, by the focus level of activist investor. NB: 'Both' infers a proxy contest waged by a group comprising of a primary or partial focus activists and another focus type. 2020 YTD is as of September 1. *Source: Activist Insight Online*

## Board representation demands by dedicated activists



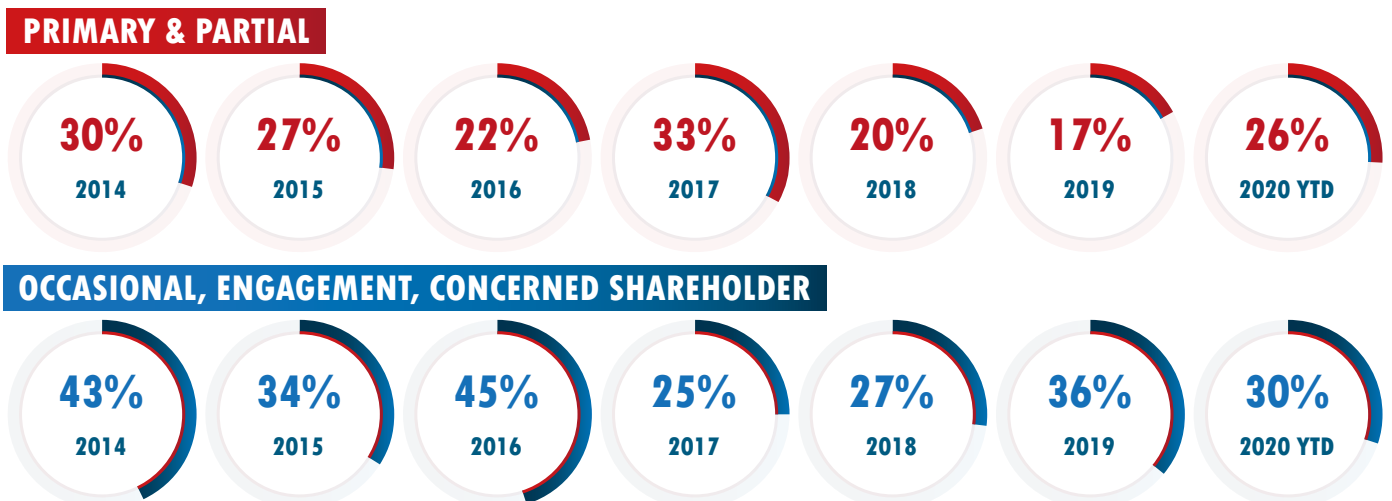
Number of board representation demands made of U.S.-based companies by primary and partial focus activists by year. 2020 YTD is as of September 1. *Source: Activist Insight Online*

## Top activists by board seats gained



Top activists by the number of board seats gained at U.S.-based companies since 2014. *Source: Activist Insight Online*

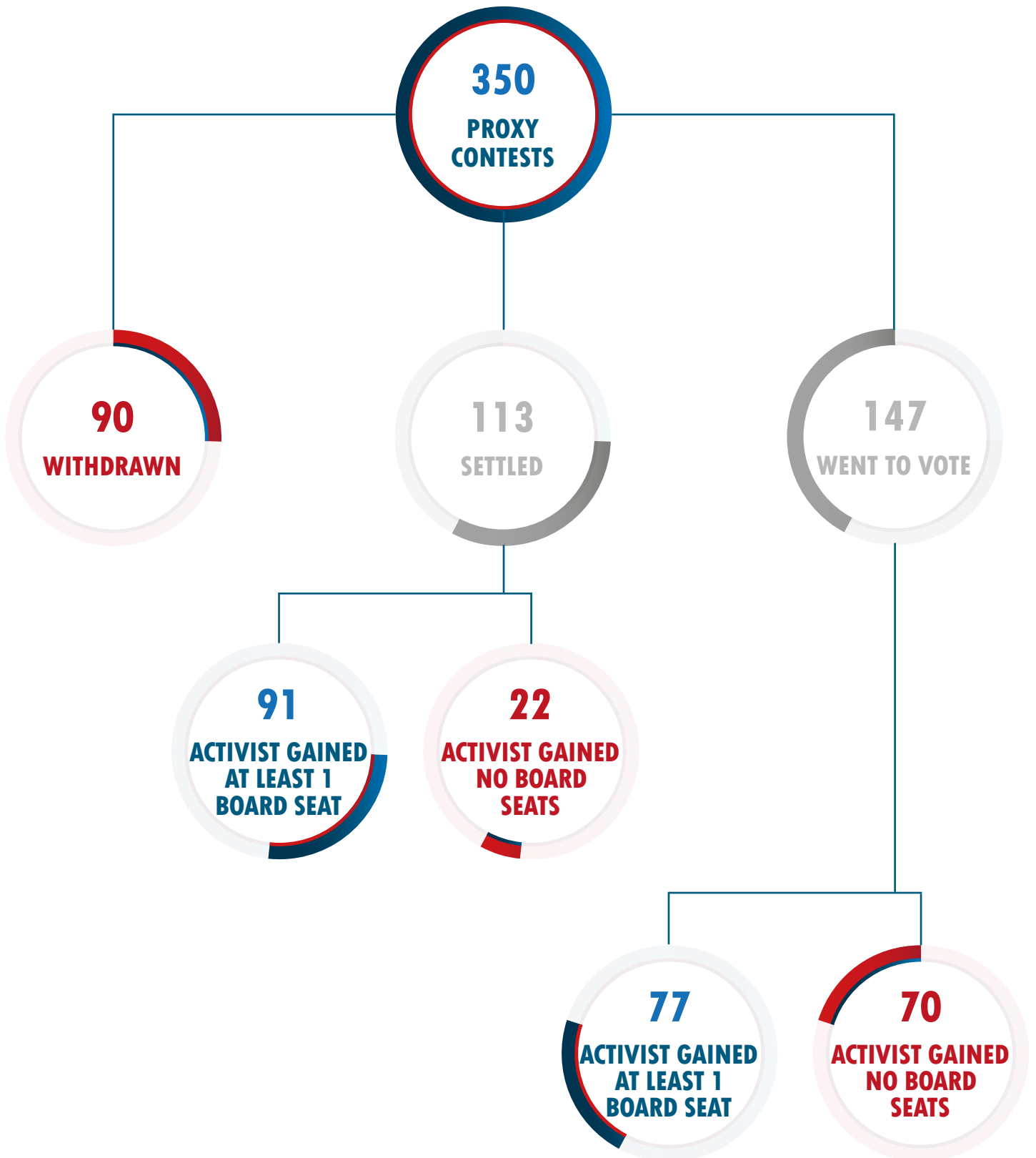
## Proxy contests as proportion of all board representation demands by focus type



Percentage of board representation demands made by activists of U.S.-based companies that resulted in a proxy contest, by year and by activist focus level. NB: Excludes demands put forward by a group of 'both' types. 2020 YTD is as of September 1. *Source: Activist Insight Online*

# PROXY FIGHTS BY NUMBERS

The evolution of proxy contests



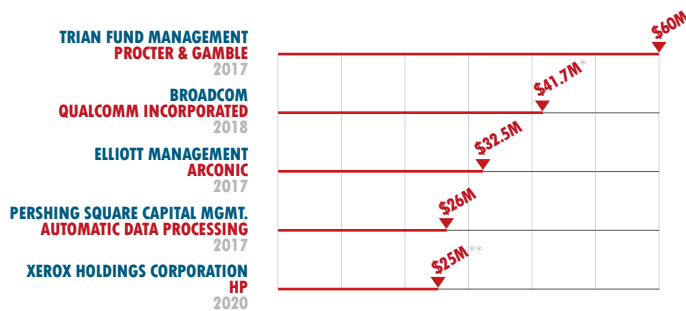
Outcome of proxy contests waged against U.S.-based companies since 2014.  
Source: Activist Insight Online

## Top proxy contests by boards seats won by an activist



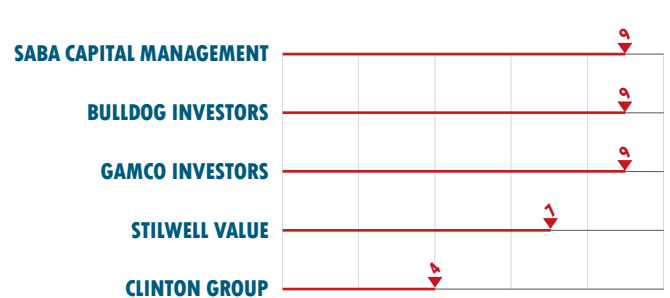
Top proxy contests waged by primary and partial focused activists at U.S.-based companies by number of board seats won by the activist since 2014.  
Source: Activist Insight Online

## Most expensive proxy contests



Top proxy contests at U.S.-based companies by combined anticipated issuer and activist spend since 2014. NB: Based on officially disclosed figures only. \*Hostile bid \*\*Issuer anticipated spend disclosed only.  
Source: Activist Insight Online

## Top activists by proxy contest votes



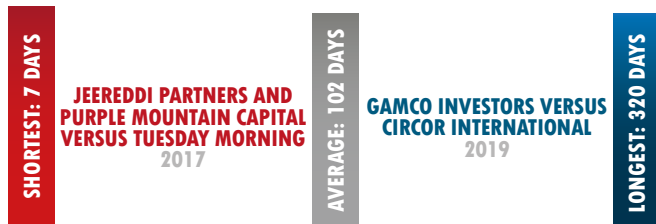
Top activists by number of proxy contests at U.S.-based companies that went to a vote since 2014.  
Source: Activist Insight Online

## The longest and shortest

### TIME TO RESOLVE A PROXY CONTEST



### TIME TO SETTLE A PROXY CONTEST



Longest, average, and shortest times to resolve a proxy contest.  
Source: Activist Insight Online

## Investor support for dissident slates

	BLACKROCK		VANGUARD		STATE STREET	
	#	VOTED FOR	#	VOTED FOR	#	VOTED FOR
2014	21	47.6%	21	28.6%	16	18.8%
2015	17	23.5%	17	23.5%	12	16.7%
2016	19	31.6%	19	31.6%	13	15.4%
2017	17	23.5%	16	37.5%	13	38.5%
2018	14	14.3%	14	42.9%	13	15.4%
2019	11	18.2%	11	27.3%	12	25.0%
2020	6	33.3%	6	16.7%	4	0.0%

Number of proxy contests investors have voted at, and the percentage of times the investor has voted for at least one dissident nominee.  
Source: Proxy Insight

# MAKING THE CASE IN 2021

Developing a compelling narrative that accurately conveys a commitment to value creation and social responsibility will be critical for companies to secure support from shareholders, advisory firms, and other key stakeholders.

By Reevemark's Paul Caminiti, Renée Soto, and Nick Leasure.

Some issuers may have been spared from contested votes in 2020. While COVID-19 remains with us and is likely to keep shareholder meetings virtual in 2021, we believe the uncertainty will no longer be enough to insulate underperformers. More traditional activist demands will return to the fore and other stakeholders will feature more prominently than in the past.

In addition to performance, both companies and activists should ready themselves for an increasing focus on issues ranging from diversity, equity, and inclusion to long-term sustainability. Leo E. Strine, Jr., former Chief Justice of the Delaware Supreme Court, has gone so far as to state that the familiar acronym ESG (environmental, social, and governance) should be extended with an additional "E" for employees.

As a sign of the rising prevalence of EESG, institutional investors are incorporating ESG metrics into their allocation and voting decisions. In addition to generating returns for shareholders, companies must also demonstrate good corporate citizenship and articulate a sound rationale for how today's investments will benefit all stakeholders over the long term.

## CONTROL WHAT'S CONTROLLABLE

Because nearly all companies have been impacted by COVID-19, performance relative to peers will remain an important data point. Outperformance suggests a company got its response to COVID-19 right and is well positioned for incremental growth. Companies that fall in the bottom half of their peer group will need to explain how geographic factors, differences in customer base, or other variables impacted their business disproportionately and effectively communicate decisive actions taken to resume a path towards growth and outperformance.

While critiques of recent stock price or sales performance may not carry the same weight in a pandemic, companies still must be prepared to defend their strategy, capital allocation policies, and business decisions during the health crisis. If an activist criticizes a company's pandemic response, issuers should focus on how they managed what was within their control. Effectively communicating smart decisions by leadership in the face of new challenges and how the business is being positioned for the future will be key to building support and winning votes.

## INCREASED FOCUS ON DIVERSITY

In this age of heightened social awareness, shareholders are increasingly likely to support calls for a company's board and leadership to more closely resemble that of its employees, customers and the broader population – and smart activists are on the hunt for more diverse candidates. While the proportion of female directors is increasing, women remain a significant minority on boards and in board leadership roles, and only a small fraction of public companies have a majority of female directors. Evidence suggests that truly diverse, engaged, and egalitarian boards score better on ESG performance and oversee companies that are more innovative. Underperformers whose leadership appears stuck in the past will be dealt with more summarily than in prior years, and all issuers will need a strong narrative as to why their board has the right mix of skills, experience, and diversity to drive value creation and lead the company forward.

## DEAL OR NO DEAL

The familiar call to put a company up for auction or to divest a unit will be more closely scrutinized, and depend more on company or specific business unit circumstances. If share price has been negatively impacted by the pandemic, issuers will be justified in pushing back on an activist as shareholders are unlikely to support an auction process at depressed valuations. Nonetheless, companies are looking for ways to turbocharge growth. In a volatile market, with big gaps between winners and losers, those who pursue transactions requiring shareholder approval need to be prepared for a full-blown campaign from the time of announcement and mindful of regulatory approval risk and its impact on a vote. 🇺🇸



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# WHAT MAKES A SUCCESSFUL NOMINEE?

Proxy fights cannot be discussed without the accompanying topic of director nominees, the selection of whom can make or break a slate, writes Eleanor O'Donnell.

With almost all proxy fights ultimately about the composition of a company's board, selecting nominees that can win the day is imperative for both sides. And as environmental, social, and governance (ESG) issues gain traction in investment markets, activist investors are under pressure to advance candidates with an edge over their counterparts – a job made easier when the incumbent board is not up to scratch on important factors like gender diversity or independence.

**“28% of female activist nominees in proxy contests that went to a vote were successful at securing a seat on the board.”**

## GIRLS RULE

The discussion around gender has gathered pace in recent years, with California making gender diversity a legal requirement in 2018. Investors have also taken up the baton, with female activist investor nominees marginally more successful than their male counterparts between November 2015 and July 2020, according to *Proxy Insight* data. Per the data, 28% of female activist nominees in proxy contests that went to a vote were successful at securing a seat on the board, compared to 25% of male activist nominees.

Yet significant female representation on boards and activist slates is sufficiently rare to garner attention and may even sway proxy fights. Notably, in May 2018 Nathan Miller and Peter O'Malley's all-female dissident slate replaced Destination Maternity's entire board despite proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis advising against. And in one of 2020's most contentious fights, GameStop directors Carrie Teffner, Kathy Vrabeck, and Lizbeth Dunn received some of the highest vote totals in favor of their re-election, while male colleagues Jerome Davis and Thomas Nelly had twice as many votes withheld.

Cristiano Guerra, who issues recommendations in U.S. proxy fights for ISS, told a conference in October that an “unwritten rule” had formed, whereby activists “generally are not going to be targeting a woman on the board – often the only woman on the board – unless you have a woman on your slate.”

But while female nominees might bolster a slate, they are hardly a panacea. Collectors Universe expanded its board by three seats, adding two female directors, ahead of its proxy fight with Alta Fox Capital Management, which initially sought all five seats. The two sides ended up settling with an agreement to add two more female directors, transforming a board with one female director out of five into a 50:50 split on a 10-person suite of directors.

In an interview with *Activist Insight*, Agility Executive Search President Patricia Lenkov noted that with institutional investors talking about gender and appreciating the value of diversity, activists must pay attention. “Gender diversity is important,” Lenkov explained. “My philosophy is that I want qualifications first, but qualifications can be found anywhere if you look hard enough.”

## THE IMPORTANCE OF INDEPENDENCE

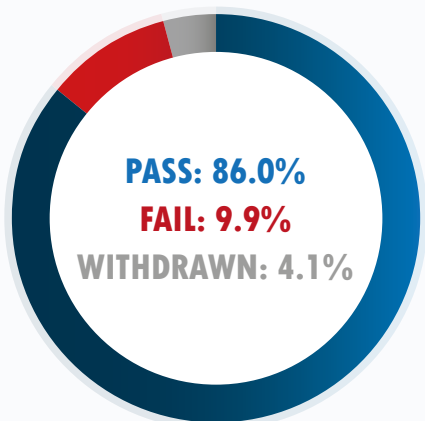
Incumbent board members also have a higher chance of keeping their seats if they are independent. According to *Proxy Insight* data, as of July 29, 83% of management nominees successfully elected at proxy contests were independent.

As a sign of how valued independence is, a variation on the word appeared 17 times in a press release by Mack-Cali Realty during its proxy fight with Bow Street Capital early in 2020, with gender diversity mentioned just once. Even so, *Activist Insight Governance* data suggest 37.7% of companies in the Russell 3000 have less than 81.5% independent directors, the average for the index.

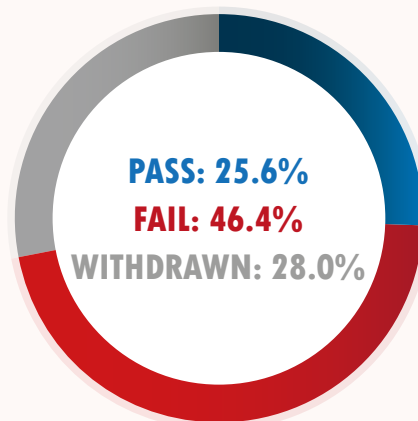
Lenkov explained that it's easy to tell if a director should no longer be on the board according to their age and tenure, “but if you look at boards often and know this world, you can tell who has been put on for objective reasons.” The recruiter noted boards should identify which directors don't check the boxes that the company needs. 🇺🇸

# Success rate of director proposals during proxy contests

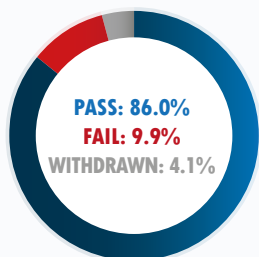
## ALL ISSUER NOMINEES



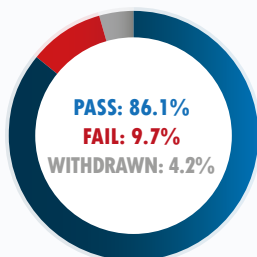
## ALL ACTIVIST NOMINEES



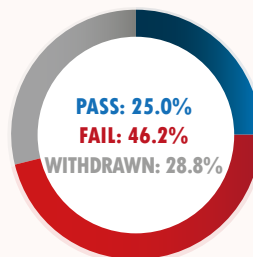
### MALE ISSUER NOMINEES



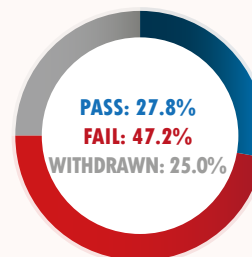
### FEMALE ISSUER NOMINEES



### MALE ACTIVIST NOMINEES

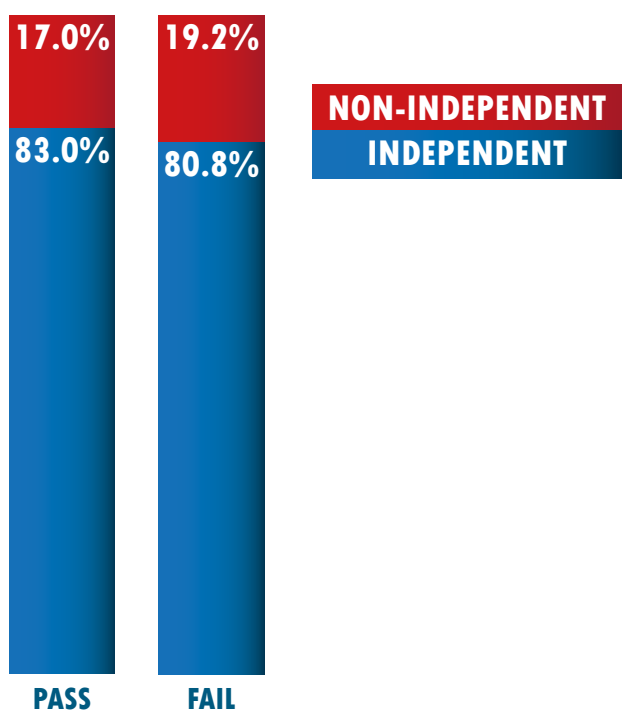


### FEMALE ACTIVIST NOMINEES



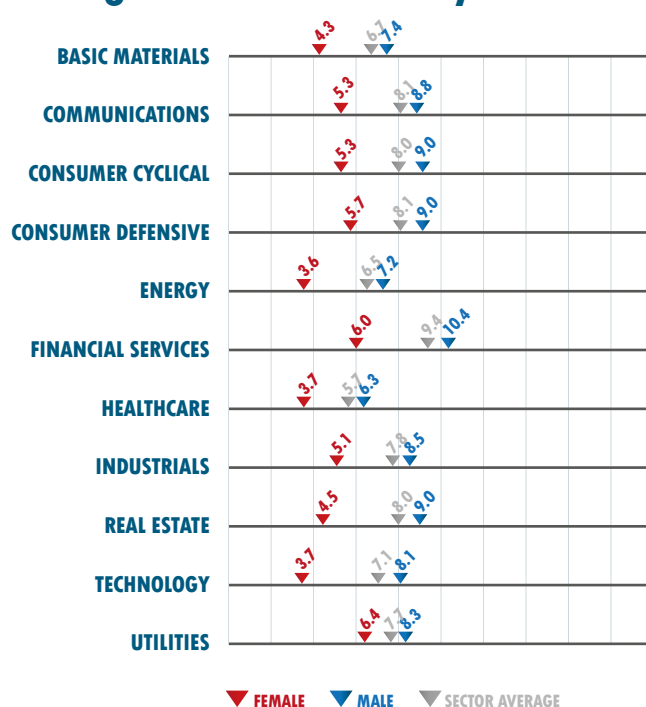
Success rate of director proposals made by issuers and activists during proxy contests since 2015.  
Source: Proxy Insight

## Independence of issuer nominees



Independence of management nominees by proposal outcome since 2014.  
Source: Activist Insight Governance

## Average director tenure by sector



Average tenures (in years) of Russell 3000 companies' directors.  
Source: Activist Insight Governance

# PROXY FIGHTS IN THE AGE OF ENGAGEMENT

Proxy contests bring inevitable and unexpected costs that fall disproportionately on the issuers. Regular touchpoints build trust, provide important feedback, and are critical to securing support in a proxy fight, writes Mike Verrechia, managing director of Morrow Sodali's M&A and Activism Advisory Group.

The ways in which we engage with shareholders, and the tools we have to do so, are dramatically different from my early days in proxy solicitation over 20 years ago. Back then, most engagement and “vote capturing” was reserved for the time between mailing and the meeting, when proxies were in hand and there was an action for shareholders to take.

Now, offseason engagement with institutional investors has become an annual event as synonymous with October as pumpkin-spiced lattes. This provides voting decision-makers and corporate engagement teams with a more meaningful dialogue, and hopefully a better understanding of what is important to each party.

Under the lens of proxy contest preparedness, these regular touchpoints can build trust, provide important feedback and transparency, and prove to be critical in securing an institution's support when it is most important. Even when institutional investors are too busy to engage, you get points for trying.

## WAR GAME YOUR GAME PLAN

Where “the age of shareholder engagement” has some pitfalls lies in the theory that talking to the top 10-20 institutional holders represents a thorough and complete outreach program. If a company has genuine vulnerabilities and concern about a potential activism event, then a more robust engagement strategy across ALL shareholder constituencies is required. Taking a proactive and periodic look at how a contest can be won, from the perspective of the company's specific shareholder profile, is fundamental.

Issuers with a large retail component should not be reaching out to that population for the first time when they are confronted with a proxy contest and there are competing ballots in the mail. Many proxy contests that go all the way to a vote are close and individual retail holders can become major factors in securing a victory. This is especially true when you consider that most proxy contests occur at small- to mid-cap companies, where there can be a larger individual holder footprint.

## WHAT SHOULD ISSUERS AND ACTIVISTS KNOW ABOUT THE COSTS OF PROXY CONTESTS?

Aside from a team of strategic advisors across legal, public and investor relations, investment bankers and proxy solicitation, there are also a number of logistical costs that may be unavoidable in a defense campaign. When working with issuers, I have found that they expect the costs of the solicitation to increase, but often don't fully understand by how much or why.

Here, the playing field is truly different for each party. The initial distribution of proxy soliciting materials is almost always more expensive for the issuer, which is not only required to deliver proxy materials to every holder as of the record date but also the annual report/10-K. Combined with the common practice of conducting four or five mailings to shareholders throughout the course of the campaign, costs can easily snowball. Issuers that have grown accustomed to the use of Notice and Access, and the savings that come with it for a standard annual meeting, should expect very different rules for proxy fights.

Activists, by contrast, can look strategically at the issuer's shareholder base and target an impactful and efficient distribution level that reaches the greatest number of shares with the least number of holders. Subsequent mailings for both issuers and activists do not need to be distributed to all holders, which can help curb overall campaign costs. 🇺🇸



**MIKE VERRECHIA**  
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# AFTERPARTY

Proxy fights are routinely criticized as unnecessary distractions by management teams. Data suggest they have a point, writes John Reetun.

Activists and issuers alike see proxy fights as bad for business, and data suggest they are right.

The stocks of companies involved in a contested vote between 2014 and September 2020 declined by an average 1.8% in the 90 days following a vote, though this short-term decline is offset by a nearly 5% rise in the 12 months following the contest, according to data from *Activist Insight Online*.

## MIXED LEGACIES

The returns are unevenly distributed, both by year and by outcome. In proxy fights where activists won at least one seat in a contested vote, the companies' stocks declined by an average 0.4% over 90 days, compared to a 3.2% decline when management prevailed.

But companies where management's slate prevailed performed better over a longer period. They experienced half the decline over a 180-day period as those where activists were at least partially successful, and rose by an average 8% after a year, compared to a 2% gain for companies where activists won at least one seat.

**“The short-term returns are worse when the company is consumed by the battle, but that reverses once things get back on track.”**

This admittedly narrow subset of activist campaigns contradicts the results of a 2015 paper co-authored by Harvard Professor Lucian Bebchuk, on the long-term effects of shareholder activism. Bebchuk's study found activist intervention proves beneficial in the long-term, noting how the ebb and flow of a campaign, including those that go to a vote, illustrates how “the stock appreciation accompanying activists' initial announcement reflects the market's correct anticipation of the intervention's effect, and the initial positive stock reaction is not reversed in the long term.”

## A CERTAINTY PREMIUM

Nonetheless, the data may explain why dedicated activists have increasingly shied away from using proxy fights, and why they are so feared among the investor community.


Penn State University Assistant Professor Mark Desjardine suggests that like other major events in a company's life, it is uncertainty that dictates the share price. Desjardine told *Activist Insight* that while proxy contests require more resources from a company, they usually lead to bigger changes, noting that “the short-term returns are worse when the company is consumed by the battle, but that reverses once things get back on track.”

Early data for 2020, when many companies were grappling with the impact of COVID-19 on their businesses during proxy season, lend support to this argument. Ninety-day stock price changes following the outcome of a contested vote or settlement comfortably trumped those of previous years.

Moreover, recent records show nearly 85% of proxy fights happen at companies with a market capitalization of less than \$2 billion and which might be more vulnerable to destabilization. Returns following proxy fights were better in years that saw a relatively high proportion of fights at companies with a market cap of more than \$2 billion.

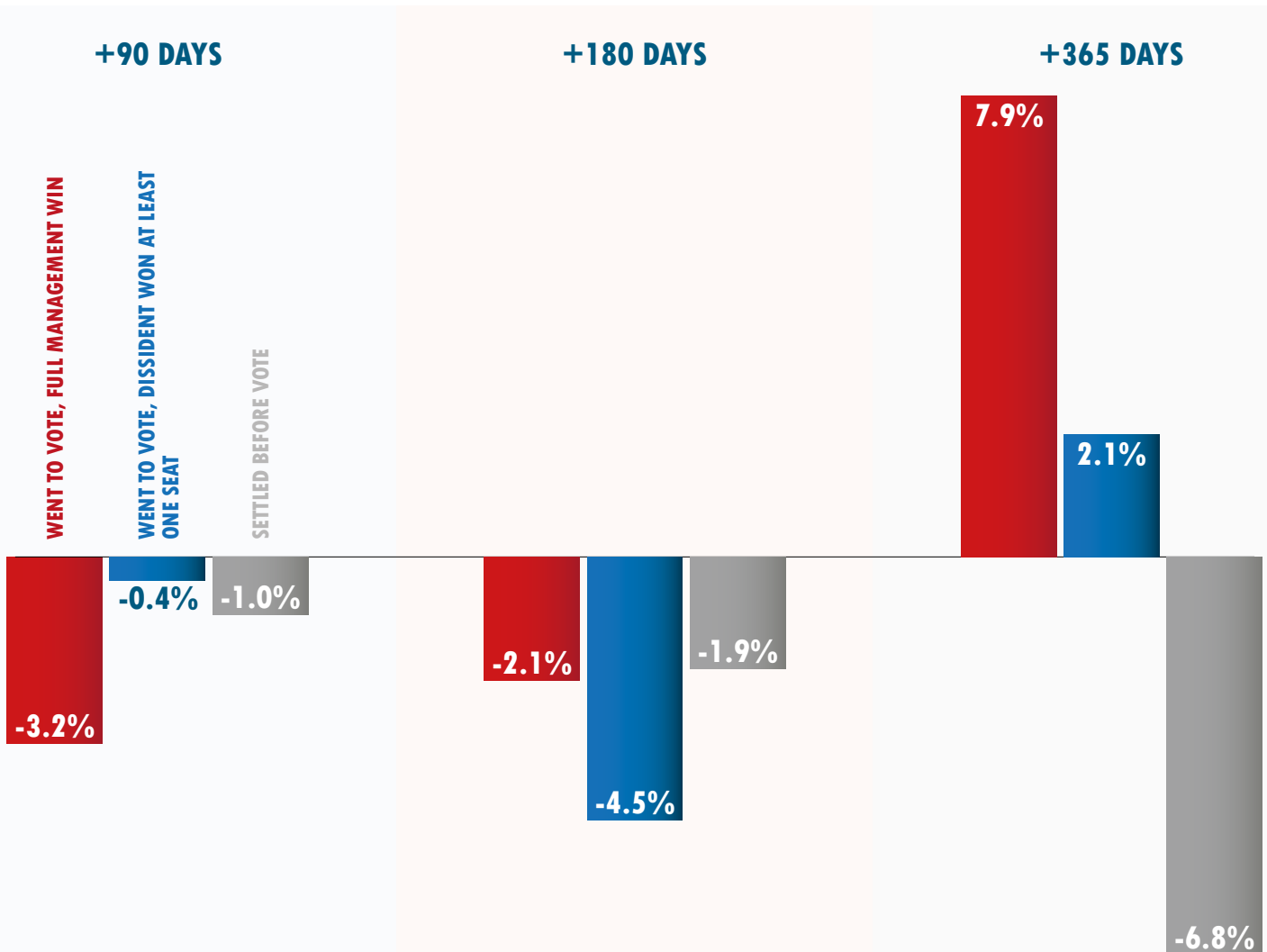
## NOTHING PERSONNEL

The impact of proxy fights extends beyond the basic impact on a company's short- or long-term share price. According to *Activist Insight Governance* data, since 2014 120 U.S. companies have announced director appointments or departures within 12 months of a proxy contest where the activist did not win any seats – only marginally less than the 138 companies that announced director changes in the same period where an activist gained at least one seat.

Indeed, CEOs from DuPont's Ellen Kullman onward have found that winning a proxy contest doesn't necessarily ensure job security. One of 2019's most notable proxy fights never came to a vote, with financial regulators stopping Voce Capital Management from advancing a slate at Argo Group International. The activist signaled it was up for a rematch, but before it could requisition a meeting the company retired its CEO and replaced five directors, going on to settle with Voce. 



## Average share price change following a proxy contest



Average share price movement of U.S.-based companies facing a proxy contest by outcome in the following 90, 180, and 365 day periods after outcome date since 2014. Source: Activist Insight Online

### Following a proxy contest...

**138**

U.S.-BASED COMPANIES HAVE ANNOUNCED DIRECTOR APPOINTMENTS OR DEPARTURES IN THE 12 MONTHS FOLLOWING AN ACTIVIST GAINING A BOARD SEAT VIA A PROXY CONTEST.

**77**

U.S.-BASED COMPANIES HAVE ANNOUNCED DIRECTOR APPOINTMENTS OR DEPARTURES IN THE 12 MONTHS FOLLOWING AN ACTIVIST GAINING A BOARD SEAT VIA A PROXY CONTEST THAT WENT TO A VOTE.

**120**

U.S.-BASED COMPANIES HAVE ANNOUNCED DIRECTOR APPOINTMENTS OR DEPARTURES IN THE 12 MONTHS FOLLOWING AN UNSUCCESSFUL ATTEMPT BY AN ACTIVIST TO GAIN BOARD SEATS VIA A PROXY CONTEST.

**61**

U.S.-BASED COMPANIES HAVE ANNOUNCED DIRECTOR APPOINTMENTS OR DEPARTURES IN THE 12 MONTHS FOLLOWING AN UNSUCCESSFUL ATTEMPT BY AN ACTIVIST TO GAIN BOARD SEATS VIA A PROXY CONTEST THAT WENT TO A VOTE.

Since 2014 for U.S.-based companies. Excluding directors appointed by the proxy contest itself. Source: Activist Insight Online and Activist Insight Governance

# STAND YOUR GROUND

The old ways in which management teams dealt with proxy fights are no longer a guarantee of success but they might buy time so long as they don't harm your message, writes Jason Booth.

When it comes to proxy fights, all sides seem to agree that it's best to avoid them. But if a fight is the only option, defense practitioners say the key to winning is to be more active than the activist in communicating with shareholders and other constituents, and if needed, throw in a few legal and regulatory hurdles to disrupt the dissident's campaign.

**“You can't treat these people as the enemy, they are shareholders.”**

## PREPARE THE GROUND (WITH TRAPS)

“Boards are looking at themselves through the eyes of an activist,” said Lawrence Elbaum, co-head of Vinson & Elkins' shareholder activism practice. To do so, they need a proxy defense team which along with the company's internal staff includes legal, public relations, proxy solicitation, and an investment bank to conduct due diligence, run through settlement scenarios, and identify key messaging for various constituents.

Thorough due diligence might uncover weak spots in the activist campaign, especially in regulated industries. Driver Management's recent campaign at First United was disrupted by a regulatory investigation, while Voce Capital was compelled to withdraw its five-person slate at Argo Group after two state insurance regulators revoked their approvals for solicitations. Both companies have denied any role in instigating the investigations. Or the dissident's board slate might prove vulnerable. Standard General withdrew one of its nominees to Tegna's board due to concerns over contractual obligations. Blue Lion Capital last year withdrew its entire slate at HomeStreet after the company rejected the nominations, claiming the activist's notice “was incomplete in myriad ways.”

And following changes in Securities and Exchange Commission (SEC) regulations, it has been suggested that management teams could start to challenge proxy advisory reports or provide rebuttals through their new distribution channels to sway proxy votes, although the first party to do so was an activist.

## REACH OUT AND TOUCH FAITH

Yet such legal and regulatory maneuvers are delaying tactics at best. What really wins proxy fights is communicating clearly and regularly with shareholders to explain how management is working in their best interest. “You have to come out and talk about what you are doing well,” said Elbaum. “If you are doing something wrong then tell shareholders about it.”

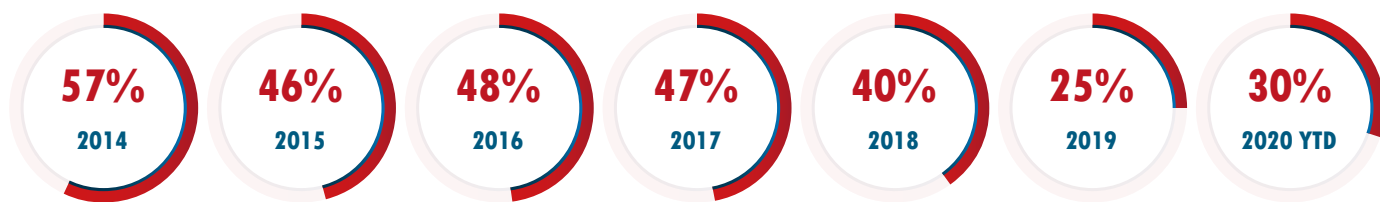
A decade ago, management's standard response to an activist, if it responded at all, was to brand dissidents as vultures and greenmailers. That tactic can now backfire as activists have become more sophisticated and increasingly respected by other shareholders. “You can't treat these people as the enemy, they are shareholders,” said Paul Caminiti, founding partner at public relations firm Reevemark, noting that an overly aggressive response might make other shareholders question your commitment to shareholder rights in general.

Campaign websites have long been a way for activists to get their message to shareholders. Now companies themselves are creating dedicated websites to counter activist allegations. A current example is CoreLogic, which created the website “corelogicvalue” for its ongoing proxy fight with Cannae Holdings and Senator Investment. Likewise, with Tegna in its successful proxy defense against Standard General.

Management teams are also taking to social media. Following calls from Elliott Management to enhance shareholder value, Marathon Petroleum Chairman and CEO Gary Heminger posted a YouTube video to admit that the company's share price “did not reflect” underlying value and explained his team was already looking at ways to rectify the situation. Yet sometimes the best way to win proxy fights, especially when it comes to retail investors, is to reach out the old-fashioned way. In DuPont's successful defense against Trian, the company identified every shareholder owning more than \$1 million in stock. Then, according to former Chief Executive Ellen Kullman, “I called them personally and some of them actually called me back.”

**“If you are doing something wrong then tell shareholders about it.”**

## ISS support for dissident slates by year



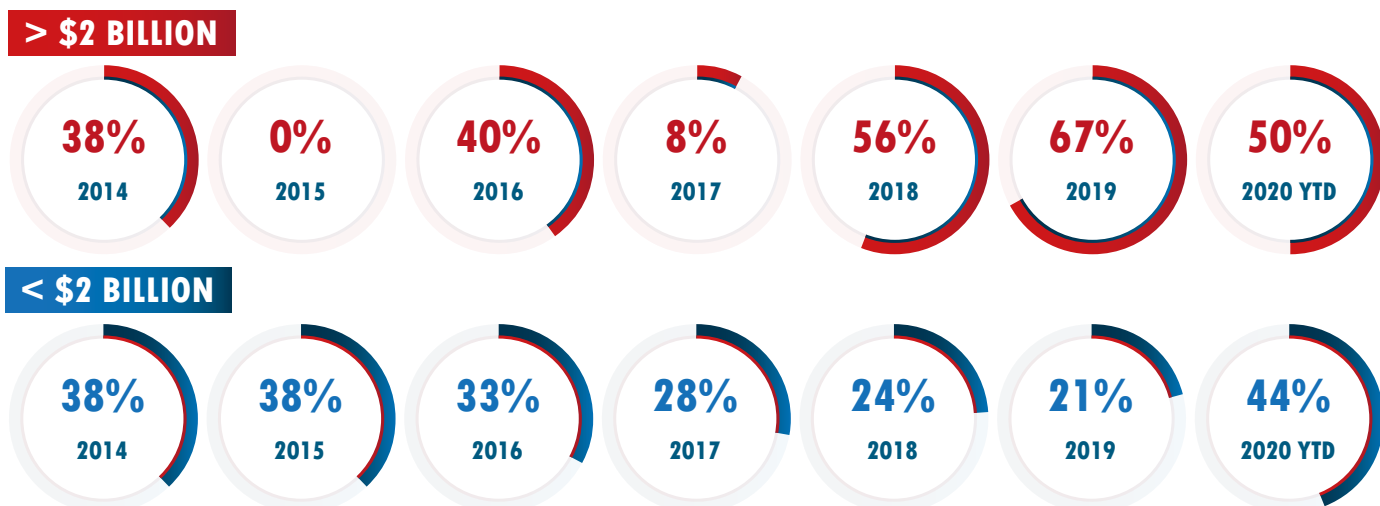
Percentage of proxy contests at U.S.-based companies where ISS supported at least one dissident nominee. Source: Proxy Insight

## Proxy contest solicitation costs by year



Anticipated activist and issuer proxy solicitation costs by year at U.S.-based companies. 2020 YTD is as of August 21. Source: Activist Insight Online

## Proportion of proxy fights that are settled, by market cap



Settlement rates for proxy fights at U.S.-based companies since 2014, split by market cap. 2020 YTD is as of September 1. Source: Activist Insight Online



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