

## Activism and the Art of Readiness, Part II: Practical Considerations for Investor Relations Officers

Last year, we published a primer for Investor Relations Officers emphasizing the important front-line role that they play when their company is engaging with an activist shareholder. We subsequently hosted, alongside Scott Hopkins and Michael Hatchard of Skadden, a series of roundtables attended by Investor Relations Officers, that went beyond theory to address practical considerations for activist engagement.

Reviewing case studies of several real-life situations in which we have been involved, the debate underpinned that there is no “one size fits all” approach, with each specific event having discrete characteristics. While significantly more involved than can be captured in a few bullets, we thought it worth sharing the key takeaways from some of the more prominent topics discussed. Please get in touch if you’d like to probe deeper into the topics outlined.

### Important role of the IRO when “taking the first call”

- Be in “listening mode” and treat an activist like any other shareholder to maintain control of initial conversations
  - \* Use the initial conversation as a fact-finding exercise, teasing out an activist’s areas of focus through the kinds of questions asked
  - \* Ask explicitly whether the activist has taken a position in the company or is still conducting due diligence
- Assume that an activist has already been in discussion with other shareholders, suppliers, customers, former employees, etc., to test and / or refine its thesis and assess receptivity among institutional investors
  - \* US activists have become more sophisticated in how they communicate with non-US institutions and are receiving an increasingly warm reception by the “long-only” community
  - \* Index funds shouldn’t be taken for granted and often support activists — engaging the governance / voting committee is key to success...the activist will be doing the same
- Objectively reporting the tone and content of the conversation to executive management and the Board will support clear thinking when considering next steps
  - \* Establish IR’s role on the core response team early and closely coordinate with the GC/CoSec to ensure executive management and the board are suitably briefed and aligned on a strategy for investor engagement

### Fund affiliated directors are a double-edged sword

- A clear and coherent investment case will act as a strong anchor for company advocacy if an activist puts out an alternate thesis
- Deciding to accept or resist an activist director nominee is a complex issue — IR input to decision making and coordination with the legal team is crucial, as is the judgment of experienced advisors
- What a company’s core investors are willing to tolerate vis à vis activist representation on a board is a key input to decisions related to the response to activist overtures, potentially accepting them but with certain conditions, and how any relationship agreement is structured
- Different activists take different approaches to director nominees, with some always nominating qualified directors unaffiliated with the fund, some always nominating affiliated directors, and others taking a hybrid position. For example:
  - \* Tends to nominate unaffiliated directors: Elliott
  - \* Tends to nominate affiliated directors: ValueAct, Cevian, Triam, Sherborne Investors
  - \* Hybrid (situation dependent): Third Point, Pershing Square, TCI, Jana

- The director(s) will likely be sharing board papers with a team of analysts that provides him / her with a basis for questioning management at a level of detail normally not available to other NEDs
  - \* Some NEDs find this helpful, but it needs to be managed carefully so as not to create a two-tiered board
- It is critical to use a relationship agreement as a mechanism to ensure the director does not suffer a fiduciary conflict between his / her obligations under the Companies Act and duties owed to fund investors
  - \* How you set clear limits to what information is shared outside of the boardroom, and with whom, is a key consideration when an activist affiliated director or directors join a corporate board
  - \* Tight controls around how the activist trades shares and maintains ownership is critical to ensuring that there can be no suspicion that material non-public information isn’t being used to inform trading decisions and that the activist continues to maintain a significant economic interest, commensurate with a board seat
- Qualified independent director nominees — either nominated by a fund or agreed mutually between the company and the fund — will often seek to ensure that they are working in the best interests of the company
  - \* Activists risk that independent director nominees “go native” and support company decisions not aligned with activist thesis
  - \* Activist nominated directors can sometimes fundamentally change the boardroom dynamic and chemistry between directors, changing how the board functions

### Recent revisions to the UK Corporate Governance Code regarding the role and empowerment of the NED creates opportunities for activists to influence the boardroom

- US-style committees of independent directors could become a more prominent feature of activist campaigns / settlement requests — e.g., establishing an independent committee to explore strategic alternatives or evaluate an acquisition proposal; establishing new board committees to reinforce the voice of the independents
- Increased potential to squeeze the chairman given new obligations to empower the independent board voice
- Activists will likely take extra measures to ensure their director nominees are classified as NEDs, not shareholder directors
- Activists will almost always seek to place their nominees on the committees of greatest influence

### Adequate preparation, a strong investment case, and credibility with core investors are inoculating factors

- Companies should “be their own activist” and regularly stress-test for strategic, financial, operational, legal, and communications vulnerabilities
- Investor confidence and trust in management and the board is a mitigating factor even in periods of sustained underperformance — good communication is key to establishing this

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