

CEOs In Hot Seat As Activists Get Bold About Replacements

By **Chelsea Naso**

Law360, New York (July 21, 2017, 5:10 PM EDT) -- Shareholder activists are increasingly setting their sights on replacing public companies' chief executives, with many making the push early and publicly in campaigns as large-cap companies continue to draw scrutiny, a recent report shows.

The trend — highlighted in a half-year review released by Activist Insight and Olshan Frome Wolosky LLP — came into focus during the first six months of the year as a number of well-known activists went to the mat with large-cap public companies' top brass and secured a handful of wins.

Those high-profile wins include Elliott Management Corp.'s successful ouster of Arconic Inc. CEO Klaus Kleinfeld, Marcato Capital Management LP's removal of Buffalo Wild Wings Inc.'s CEO Sally J. Smith, and Mantle Ridge LP's ability to get E. Hunter Harrison appointed as CEO of CSX Corp.

Although pressuring CEOs is not a new play for activists, the effort to remove them from the outset of a campaign, rather than quietly see them go once board seats have been won, is a change of pace.

"The big development is the candor, for lack of a better term, on the part of the activists to be more upfront about the fact that not only do they want succession or replacement but they also have the candidate they would like to see take over the role," said Eduardo Gallardo, a Gibson Dunn & Crutcher LLP partner.

All three of the examples — Arconic, Buffalo Wild Wings and CSX — saw the focus on the removal of the CEO from the early stages of the campaign, even though each played out differently.

Elliott called for the dismissal of Kleinfeld from Arconic when it launched its campaign in January and ultimately secured his departure when it was revealed that, as the fight heated up, the CEO had sent a letter seen as a veiled attempt to threaten Paul Singer, Elliott's founder.

Buffalo Wild Wings' Smith, on the other hand, will part ways with the company she's led since 1996 on a much less abrupt basis. Smith, pushed out by Marcato Capital, plans to retire at the end of the year or will leave sooner if a replacement is named before then.

The campaign at CSX saw Mantle Ridge crop up with Harrison in hand, and urged the transportation company to bring him on as CEO. Harrison was hired by the company in March, shortly after former CEO Michael Ward said he would retire and become a consultant to CSX. The same day CSX announced Harrison's appointment, the company also announced an agreement to bring on five directors "mutually

agreed upon” by the company and the hedge fund.

The plays, which are not the only ones seen so far this year, highlight the growing emphasis on getting to a company’s problem at the root right from the beginning of a campaign.

“The ugly truth is that in many underperforming companies the problem lies with the CEO. ‘The fish starts to stink from the head,’ as we say in German,” said Kai Liekefett, head of Vinson & Elkin LLP’s shareholder activism practice. “Activists always knew that, but they used to be more circumspect about their ultimate plans to replace the CEO out of fear that shareholders to be reluctant to support such drastic change. Nowadays, activists are bolder because they have seen that shareholders are actually often supportive of change on the top, in particular where the activist has already identified a credible new CEO candidate.”

While there were a number of headline-making activist plays that focused on CEO replacement or succession, that is mostly a large-cap trend, with smaller activists generally targeting small- and mid-cap companies with their sights set on quick liquidity events, noted Keith Gottfried, a Morgan Lewis & Bockius LLP partner.

“In the large-cap situations, I think you see a lot more operational activism than you see in the small-cap. In the small-cap arena, you want to force some kind of event that creates liquidity and unlocks value fairly quickly but they’re not as focused on operation activism,” he said.

“Smaller-cap activism is a lot easier. The companies are undefended and the companies are often not that well-advised. They don’t want to spend money on advisers and might be easier to intimidate and force into a settlement because the board doesn’t have the stomach for a fight,” Gottfried added.

And, despite the handful of high-profile plays, the number of public campaigns is still trending behind the activity seen in 2016, the Activist Insight and Olshan report found. Halfway through 2017, there were 485 companies publicly targeted, down from the 536 targeted in 2016 but still marking an increase from the 450 seen during the first half of 2015, according to the report.

With proxy season winding down, the report projects that the full year will see about 760 public campaigns, sitting behind the 806 recorded last year.

The difficulty in tracking activist activity, however, is the fact that not all campaigns are public. Companies may choose to settle quietly with activists, or may even face pressure from nontraditional activists like institutional investors keen on bringing about change.

“Particularly now that boards are so sensitive to the threat of an activist campaign, I get a lot of calls from clients when they have a challenging discussion with an investor and they’re concerned that that investor is going to bring a proxy fight,” Gottfried said. “It’s a lot easier for an institutional investor that has historically never filed a 13-D to dabble from time to time in activism to get the company to adopt some changes.”

Although the U.S. is seeing a slight slowdown, there is a growing number of campaigns being launched overseas, particularly in Europe and Asia, as U.S. targets become more difficult to track down.

“In the U.S., there have been over 200 activist hedge funds looking for targets for over 15 years, so much of the low-hanging fruit has already been taken. Europe and Asia, by contrast, are replete with

underperforming mismanaged companies, offering activist hedge funds an entire pool of new worthy targets,” Liekefett said.

The strategy is also being adopted by domestic investors in those regions, noted Gallardo.

“At the same time, you’re seeing the development or adoption of the activism strategy by some foreign funds that are learning or mimicking the strategy of large U.S. activist hedge funds,” he said.

--Editing by Rebecca Flanagan and Emily Kokoll.

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