

## Activists Expected To Target M&A, Overseas Cos. In 2019

By **Chelsea Naso**

*Law360 (January 1, 2019, 12:03 PM EST)* -- Shareholder activists are expected to hit the ground running in 2019, carrying over their momentum from an action-packed year with an emphasis on challenging announced transactions and targeting companies outside of the U.S.

The busy year on tap follows a record year for activism. According to Lazard's shareholder advisory group's report on activity through the third quarter, 174 campaigns have already been launched, surpassing the 169 campaigns launched throughout all of 2017.

"I've never been busier at this time of the year before in my career," said Kai Liekefett, who leads Sidley Austin LLP's shareholder activism practice. "While there's certainly a possibility that a lot of the matters I'm involved in may not result in a public campaign or a proxy fight, the reality is there will most likely be an extremely high level of activity in 2019."

Here, Law360 outlines developing activism trends that are poised to shape the coming year.

### Activists to Consider Environmental, Social Issues

Economic-focused activist hedge funds have long considered governance matters when targeting public companies, but some are now starting to consider putting their weight behind environmental and social issues to match evolving demands of society.

In an October survey of economic activist hedge funds by Schulte Roth & Zabel LLP, Activist Insight and Okapi Partners, 14 percent of respondents predicted a significant increase in environmental and social activism. Another 42 percent predicted activism surrounding the matters would "somewhat increase," according to the Shareholder Activism Insight survey.

The interest in environmental, social and governance, or ESG, issues started gaining attention at the beginning of 2017, with letters to shareholders from well-known institutional investors, like BlackRock Inc., describing plans to promote board diversity and encourage companies to evaluate their role in the community, impact on the environment and response to technological change.

The BlackRock letter, written by CEO Larry Fink, hit around the same time that activist hedge fund Jana Partners issued an open letter with the California State Teachers' Retirement System, or CalSTRS, that urged Apple Inc. to address device addiction among children and teens.

The growing interest in targeting these issues reflects the shifting concerns of society and is likely to continue to permeate shareholder activism campaigns.

“From a societal perspective, you see there are more concerns about these types of issues. It’s not surprising to see investment funds move that way as the culture moves that way,” said Eleazer Klein, co-head of Schulte Roth’s shareholder activism group.

But not everyone is convinced that economic-focused activists will truly embrace environmental and social issues.

“By and large, I don’t think the economic activists are going to be focused on that. They are going to be focused on places to make money,” said Keith Gottfried, head of Morgan Lewis & Bockius LLP’s shareholder activism defense practice.

### **Diversity Will Remain Center Stage**

Diversity — particularly gender diversity — in the boardroom has been gaining more attention as funds look for different ways to agitate for change, but the topic gained even more attention this year with California legislating that its public companies must have female board members.

California in October passed a law that would require any publicly held business with its “principal executive offices” located in the state to have at least one female director by the end of 2019. By the end of 2021, boards with five members will be required to have two female directors, while boards with six or more members will need to have three or more female directors.

The legislation notes that an increase in female representation on boards is expected to improve the state’s economy, provide more opportunities for working women and aid taxpayers, shareholders and retirees, like those with public pensions.

“Assuming that that does not get knocked down in the courts, I think that can also be a catalyst for making diversity more of an issue that the institutional investors and even the conventional activists push. It might be something that companies are targeted for,” Gottfried said.

Only time will tell however if the issue of gender diversity will become a true sticking point in activism campaigns, and if the parties involved — like proxy advisers — will use factors like gender diversity in their measure of a slate of directors up for election.

“I don’t know if it’s this proxy season, but we are going to get to a point where it becomes a critical factor in whether a board gets a favorable recommendation from a proxy advisory firm. At the end of the day, the proxy advisory firms have customers. The customers are institutional investors. I think they’re going to eventually demand that board diversity be a factor in whether a proxy advisory firm supports the election of a director or director slate,” Gottfried said.

### **Traditional Funds to Borrow From Activist Playbook**

Institutional investors and other more traditional funds are less hesitant to take a more activist approach to an investment when they feel there is a need for change, a trend that is expected to continue into the coming year. That came as somewhat of a surprise, with the majority of activists in

2016 reporting that they didn't expect institutional investors to step into the arena, according to the Shareholder Activism Insight survey.

"The activists led the charge into activism, and continue to play a predominant role. But more and more funds are realizing that when they get frustrated with positions, they don't just have to stay frustrated anymore," Klein said.

With more institutional investors taking a page out of the activist playbook, and more hedge funds entering the market, there has been an influx of first-time activists, Liekefett noted.

"We've seen more and more first-timers launch campaigns. Sometimes these are new activists, sometimes these are funds that were launched by former activist hedge fund employees who quit to open up their own funds," he said. "Oftentimes, however, these are long-term investors that decided they need to take more activist measures in certain situations."

Now that institutional investors are playing in the activist space, the trend will likely continue to grow.

"My belief is it will [continue], because the stigma previously associated with launching a proxy contest and taking other activist measures is gone in corporate America. They are less concerned nowadays with getting their hands dirty," Liekefett said.

While more traditional players are willing to dabble in the activism world, their efforts to spark change are not seen as a threat to the role of activist hedge funds in the public markets. The Shareholder Activism Insight survey found that 80 percent disagree or strongly disagree with the notion that institutional investors' increased engagement will decrease the role of activist investors.

### **Announced Deals to Draw Activist Scrutiny**

Inked tie-ups are drawing the ire of shareholder activists, with well-known names like Carl Icahn taking issue with high-profile deals like Cigna's \$67 billion takeover of Express Scripts. Deals are expected to continue to draw activists' attention, with campaigns aiming to either derail a deal or improve a deal's terms.

"We have seen a record number of campaigns against M&A transactions ... that are designed to either derail a deal or sweeten an existing one," said Liekefett.

According to Lazard's quarterly report, 34 percent of campaigns launched during the third quarter alone were M&A-driven. Of those, 30 percent are trying to derail or sweeten a deal, 42 percent are pushing for a deal, and 28 percent are calling for a breakup or a divestiture.

Aside from Icahn's Cigna efforts, this year also saw Icahn go after the now-terminated combination of Xerox and Fujifilm and saw Elliott involve itself in the takeover battle for Sky PLC.

"It's an easy way to make money," Liekefett said.

"If you try to derail the deal, what is most likely going to happen is the merger parties are going to take a long hard look at the time and effort they already spent negotiating the deal and they oftentimes just decide to sweeten the deal with a little higher price as opposed to walking away," he said.

## **More Campaigns to Target Europe, Asia**

Activist hedge funds have been increasingly targeting companies in Europe and Asia, a trend that's expected to pick up steam in the coming year.

"We're going to continue to see a lot of activists overseas and a lot of U.S. investors go overseas. I don't know anyone who is in the activist defense community who is not involved in doing something overseas right now," Gottfried said.

Lazard found that through the third quarter of 2018, 42 percent of campaigns launched targeted non-U.S. companies. That breaks down into 21 percent targeting European companies, 10 percent targeting Asian companies and 6 percent targeting Canadian companies.

And interest in non-U.S. campaigns is not expected to wane in 2019. Of the activists surveyed for the Shareholder Activism Insight survey, 30 percent see "a lot" of opportunity and 36 percent see "some" opportunity in Europe, the Middle East and Africa, which includes the U.K. Thirty two percent also see "a lot" of opportunity and 26 percent see "some" opportunity in Asia Pacific. That's on par with the 31 percent who said they see "a lot" of opportunity in the U.S. Fifty four percent see "some" opportunity in the U.S. for the coming year.

"Activists were looked at for many years as the raiders, the barbarians at the gate. That taboo has largely disappeared over time as shareholder activism has gained favor as an important counterbalance to poor management and complacent governance. We're at the point today where activist investing is viewed as a fundamental part of the checks and balances system of U.S. public company governance," said Andrew Freedman, co-head of Olshan Frome Wolosky LLP's activist and equity investment group. "And that's starting to resonate worldwide."

## **Smallest Public Cos. Remain Most-Targeted**

While activist hedge fund campaigns targeting mega-cap companies make headlines, the majority of targets are — and are expected to continue to be — small-cap companies, where there tends to be more opportunity to rally for change.

According to the Shareholder Activism Insight survey, only 25 percent of respondents anticipate "some" opportunity in the mega-cap bracket and 42 percent predict "little" opportunity there. None responded that they anticipate "a lot" of opportunity among mega-cap companies, whereas 53 percent predict a lot of opportunity among small-cap companies and 60 percent see a lot of opportunity among micro-cap companies.

That does not mean there will not be any high-profile campaigns, just that they tend to get a disproportionate amount of publicity and tend to be few and far between in comparison to activity among smaller public companies.

"It's very episodic and limited. The nature of large companies is that for the most part they are well-run," Klein said. "Smaller companies have greater operational issues. One of the reasons is that, because they are smaller, they have fewer resources and less expert management."

--Editing by Pamela Wilkinson and Jack Karp.  
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