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Yahoo's $40B Spinoff Bolsters Large Cap-Hungry Activists

By **Karlee Weinmann**

Law360, New York (January 28, 2015, 4:50 PM ET) -- Yahoo Inc.'s plan to spin off its $40 billion Alibaba Group Holding Ltd. stake roughly follows a proposal Starboard Value LP made last year, reinforcing activist investors' rising sophistication and influence over even the biggest targets — an evolution expected to define this proxy season.

The California-based company said Tuesday it will split its Alibaba interest into two independent companies, aligning with some of Starboard's September pitch to wring value from Yahoo's Asian assets. Yahoo CEO Marissa Mayer made clear the company decided on the spinoff before Starboard surfaced.

It's tough to imagine that New York-headquartered Starboard, one of the most powerful activists in today's marketplace, had no influence over a major strategic move at a company trying to claw its way back to prominence after several tough years. But that debate is a minor detail in the bigger picture.

For now, the spinoff plan quiets rumblings of a proxy fight at Yahoo, under pressure to boost returns after years hemorrhaging market share to rivals. Still, it gives Starboard a platform to showcase its muscle even without acknowledgment from its target, said Keith Gottfried, head of the activist defense practice at Morgan Lewis & Bockius LLP.

"It says a lot of good things about Yahoo and the board, that they spent a lot of time thinking about ideas and talking to corporate lawyers and tax lawyers, and trying to find the right models of how to execute," he said. "But it also says that Starboard does come to the table with some ideas — an idea that a board of a large-cap company took very seriously."

It's an important message in a climate where activists are aiming higher both in terms of their targets and their goals. By all accounts, activists are headed for another banner year in 2015, continuing their record run in recent years. As they sharpen their tactics and welcome a still-flowing deluge of investor dollars, activists threaten to flip rising interest in large-cap firms into a feeding frenzy.

Against that backdrop, companies of all stripes — even those as big as Yahoo, and, in some cases, even those doing relatively well — are on notice, said Chris Davis, who heads the investor activism group at Kleinberg Kaplan Wolff & Cohen PC.

"It comes down to the power of the idea," he said. "Starboard doesn't have the world's largest position in Yahoo. Five years ago, a company would not have paid attention to even a well-known activist at approximately 1 percent ownership. Nowadays, the landscape has changed."

In response, for the first time, attorneys on both sides of the table say they're handling an onslaught of activism-related matters dealing with large-cap targets. Activists continue to explore their options at household-name companies, while the same outfits fortify their preemptive defenses against a strike.

"The conversation around activism is really going to be more focused around large caps than on small caps," Gottfried said. "That wasn't the case last year or the year before. A lot more large caps are concerned, and more willing now to start getting educated and start getting prepared in a way they wouldn't have been so open to last year."

That process generally starts with a hard internal look at the company's operations and its board's functionality. The sharp rise in activism in general over the past several years gives companies a sort of blueprint — a collection of previous activist campaigns to weigh their vulnerabilities against.

Now more than ever before, companies' top brass are taking on more regular reviews of themselves, in theory looking through the same lens an activist would. By mimicking that process, a company can curb its exposure to a proxy fight, Skadden Arps Slate Meagher & Flom LLP partner Richard Grossman, who defends targets against activists, told Law360 last month.

"Many, many companies have heard the message," he said in an interview, speaking in general and not about any single company or activist play. "Companies are taking much harder looks at themselves and putting themselves in the activists' shoes."

At Yahoo, the outlook from here remains murky. Starboard hasn't publicly outlined any next moves, but the company has so far firmly opposed other aspects of the hedge fund's proposal, including other cost-cutting measures and the centerpiece: a merger with another erstwhile Web titan, AOL Inc.

Starboard has said a union with AOL could lift Yahoo's market position, particularly in the coveted mobile space, and deliver $1 billion in synergies. The proposed tie-up could still wind up as the focal point in a proxy contest. From there, it's all about Yahoo's board.

A boardroom battle is generally tougher to wage at a large-cap outfit, where directors tend to be suited for their positions, at least on paper. But activists wield more power than they have in the past as institutional investors and proxy advisory firms increasingly warm up to their plans.

The sea change in how the marketplace treats activists has given them new power to deliver results, a shift that has taken a firm hold at big-name companies.

"The era of boards not being answerable and feeling insulated is effectively at an end," Davis said. "Every director at a public company in America has to understand the name of the game from here on out is accountability."

--Editing by Katherine Rautenberg and Philip Shea.
