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PREPARING FOR SHAREHOLDER ACTIVISM DURING THE 2021 PROXY SEASON IN THE WAKE OF COVID-19

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The shock, turmoil, uncertainty, and lack of visibility that followed the immediate onset of the coronavirus (COVID-19) pandemic in March 2020 were significant factors accounting for why shareholder activism was relatively subdued during the 2020 proxy season. However, given that activist investors have now had more than eight months to acquire their "sea legs" and recalibrate their playbook for the evolving "new normal," it is likely that, even as the COVID-19 pandemic shows no signs of abating, activist investors will be less reluctant to wage an activism campaign in whatever "new normal" we find ourselves in during the 2021 proxy season.

Notably, unlike with respect to the 2020 proxy season, activist investors currently planning for the 2021 proxy season are making those plans aware of the existence of the COVID-19 pandemic and its evolving implications and having to anticipate and incorporate into their plans the possibility that, even if the current COVID-19 case surge is reversed and further extended lockdowns are avoided, the COVID-19 pandemic is not likely to materially subside between now and the end of the 2021 proxy season. In addition, as we will discuss below, we are likely at a point where the COVID-19 pandemic may be more of a catalyst for shareholder activism than an inhibitor. Accordingly, companies should not expect that shareholder activism during the 2021 proxy season will be as subdued as it was in 2020.

CURRENT SITUATION

While the 2021 proxy season for companies with calendar year-ends is still months away, this is the time of the year when activist investors are planning whatever campaigns they may want to wage in 2021. In that regard, now is the time when activist investors identify their targets, if not already identified, and begin to engage with companies and their boards and/or management teams. On an almost daily basis, we are seeing activist investors file Schedule 13Ds with the US Securities and Exchange Commission (SEC) disclosing their acquisition of more than 5% of a company's outstanding shares and their intent to be active with regards to such company. In some cases, the filing of the Schedule 13D is intended to place pressure on the company, its board of directors, and its management team to engage with the company. To the extent that activist investors are not successful through such engagement in getting companies to make the changes requested by the activist investors, then as we move closer to the end of 2020, activist investors will need to begin preparing advance notices of nomination to submit to companies to inform them of intended nominee slates to be presented at 2021 annual meetings. To be clear, while many activist investors would likely be finalizing their plans prior to year-end with regards to what companies they want to engage with and possibly wage a campaign against, they still retain a great deal of optionality and remains months away from being fully committed to wage any campaign at any company.

As we move closer to the 2021 proxy season, what remains unclear is how the ongoing COVID-19 pandemic will ultimately impact shareholder activism and the campaigns that activist investors will wage during the 2021 proxy season. More than eight months have elapsed since heightened concerns with the COVID-19 pandemic began to take hold and much of the world transitioned to a work-from-home environment in response to state and local government mandates that businesses close their physical locations and people adopt previously unheard of social distancing practices that foreclosed many theretofore typical forms of in-person social interaction. While there has been some hopeful reports that pharmaceutical companies are moving closer to developing effective COVID-19 vaccines, the ultimate timing for when such vaccines could be approved, commercialized, and distributed remains unclear.

It also remains unclear when we can expect to be on path to some semblance of normality. In the near-term, the COVID-19 pandemic shows no signs of abating any time soon as the United States exceeds 11 million COVID-19 cases and moves closer to 250,000 deaths caused by COVID-19. Over the past eight months, the COVID-19 pandemic has destroyed countless lives, businesses, and livelihoods, upended numerous industries, and caused extensive turmoil across the world. Never before have we seen a crisis engulf the entire world all at once. During the early months of the COVID-19 pandemic, government mandates forced numerous businesses to reduce or suspend operations and while many, but not all, businesses have since reopened, even today, numerous businesses have yet to resume normal pre-pandemic operations. The large-cap market indices like the Dow 30 and S&P 500 have recovered from the COVID-19 driven stock market crash we saw this past March, and, in the wake of the recent election of President-elect Joseph R. Biden, have tested new record highs. However, the "rising tide has not lifted all boats," and the Russell 2000, while in positive territory for the year, significantly lags behind the large-cap market indices as investors show a clear preference for large-caps, particularly large-cap technology companies that are more optimally positioned to execute in a work from home contactless environment.

To persevere through the COVID-19 pandemic and counter the loss of revenue caused by the related government mandated shutdowns and/or reduction of operations, companies have had to be creative and resourceful in pivoting their business models more in the direction of contactless commerce, developing alternative revenue streams, and preserving and identifying new sources of liquidity. The COVID-19 pandemic has also impacted demand and accelerated the shift to ecommerce and contactless commerce that had begun pre-pandemic. Not all companies have businesses easily adaptable to contactless commerce and, in some cases, their business model was historically dependent on bringing large groups of people together in relatively crowded environments. Numerous companies, unable to adapt their businesses to contactless commerce and not able to access sufficient liquidity to sustain them until a "new normal" emerges that is more akin what existed pre-pandemic, have been pushed into bankruptcy and/or liquidation and almost not a day goes by when we do not hear of a familiar company name heading towards or filing for bankruptcy and/or liquidation. In some of these cases, but certainly not all, the company may have already faced significant challenges pre-pandemic juxtaposed with a large debt burden, but the pandemic was the ultimate "nail in the coffin." While many companies have been able to rebound from the pandemic and, in some cases, thrive, the future is very uncertain for companies that are still limited in resuming operations or where demand has been adversely impacted by COVID-19 health and safety concerns.

SHAREHOLDER ACTIVISM STATS FOR THE 2020 PROXY SEASON

While shareholder activism during the 2020 proxy season did not come to a sudden halt, it was certainly down when compared to 2019. Below are some key stats demonstrating how activism in 2020 compared with 2019:

- 652 activist investor demands worldwide (as of the end of Q3 2020), 105 fewer than in Q3 YTD for 2019 and the lowest level since 2015[1]
- 367 activist investor demands at US companies (as of the end of Q3 2020), 45 fewer than in Q3 YTD for 2019[2]
- 247 proxy fights worldwide (as of October 31, 2020), compared to 259 for full year in 2019[3]
- 87 proxy fights at US companies (as of October 31, 2020), compared to 97 for full year in 2019[4]
- 169 board seats gained by activist investors in the US (as of the end of Q3 2020), 10 fewer than in Q3 YTD for 2019[5]
- Large caps in US (more than $10B) were 35% of targets, a higher percentage than in the previous three years, showing activist investors' growing preference for large caps[6]

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[1] Activist investor Insight
[2] Activist investor Insight
[3] FactSet Research, Inc.
[4] FactSet Research, Inc.
[5] Activist investor Insight
[6] Activist investor Insight

More anecdotally, like so many other activities that were reshaped by the COVID-19 pandemic, shareholder activism during the 2020 proxy season was relatively subdued such that even the activism campaigns that went the distance or at least made it past the point where preliminary proxy statements for a contested shareholders' meeting were filed with the SEC had the "volume turned down." Given all the uncertainty that the world was confronted with from March 2020 onwards, one may wonder why there was even as much shareholder activism as there was. One reason for that is that many advance notice deadlines for the receipt of director nominations and shareholder proposals had closed by the time that concerns with COVID-19 began to take hold during the beginning of March 2020. As such, by the time COVID-19 was declared a pandemic, activist investors planning campaigns for the 2020 proxy season had already decided on which companies to target, had likely begun their engagement with company management and/or boards of directors, and had already submitted advance notices to their targets disclosing their intention to nominate director candidates and/or bring other business at the company's 2020 annual meeting. That does not mean that activist investors were fully committed to waging a campaign all the way to a shareholder vote, but it does explain why, while shareholder activism in 2020 was down from the prior year, the COVID-19 pandemic did not cause shareholder activism to come to a sudden halt.

HOW COVID-19 IMPEDED SHAREHOLDER ACTIVISM DURING THE 2020 PROXY SEASON

As discussed above, while the COVID-19 pandemic did not cause shareholder activism to come to a sudden halt during the 2020 proxy season, COVID-19 certainly appears to have impeded shareholder activism in the following ways:

- Activist investors, like the rest of us, were confronted with unprecedented uncertainty and lack of visibility
- Activist investors were not insulated from the impact of COVID-19 on their investments and operations
- Lack of precedent for activist investors waging campaigns during a global pandemic and related economic shutdown
- Activist investors faced challenges in engaging with company boards and management teams
- Activist investors faced challenges in engaging with investors
- Activist investors faced challenges in pursuing a proxy contest at a virtual shareholders' meeting
- Possibility that activist investors would have been perceived as "tone-deaf" to the COVID-19 pandemic and the unprecedented challenges that companies were dealing with if they waged a campaign
- Limited ability for activist investors to criticize company performance in the immediate aftermath of an unprecedented pandemic and related economic shutdown
- Limited ability for activist investors to articulate a credible strategy for enhancing shareholder value in the immediate aftermath of COVID-19 as various popular value enhancement options fell out of favor
- Possibility that activist investor-driven board changes would not be as attractive to investors as they would be in the absence of the COVID-19 pandemic

Activist Investors Were Confronted with Unprecedented Uncertainty

As we headed into the 2020 proxy season, activist investors were confronted with unprecedented uncertainty. One would likely have to look back to World War II, some 80 years ago, for the last time when so much of the world was engulfed with a shared sense of uncertainty across multiple dimensions. Given that most activist investors were born long after that time, none has had to operate in an environment of such widespread uncertainty and lack of visibility. While many activist investors are extremely sophisticated and often reluctant to show any fear, activist investors are not immune from the same fears and concerns that were then impacting the rest of the world.

The uncertainties that faced activist investors during the 2020 proxy season included the following:

- Uncertainty as to duration of the COVID-19 pandemic
- Uncertainty as to the duration of the stay-at-home orders and nonessential business closures mandated by state and local governments
- Uncertainty as to when businesses would be able to resume operations, particularly those that were not easily adaptable to contactless commerce
- Uncertainty as to whether certain industries had been irreparably damaged
- Uncertainty as to whether certain business models had been irreparably damaged
- Uncertainty that consumer behavior had been irreparably changed and was continuing to change and how that would impact companies, industries and sectors
- Uncertainty in assessing companies' liquidity needs, given the uncertain duration of the COVID-19 pandemic and the related stay-at-home orders and nonessential business closures mandated by state and local governments
- Uncertainty that companies seeking liquidity would need to secure financing on less than attractive terms, including equity financing that may be highly dilutive
- Uncertainty as to how involved the US government would become in many industries that received government assistance to stay afloat and recover
- Uncertainty as to the outcome of the US presidential election

Activist Investors Were Not Insulated From the Impact of COVID-19 on Their Investments and Operations

With the S&P 500 and the Dow 30 indices surging and trading close to their record highs[7] in the days following the projection that the former US Vice President Joseph R. Biden had been elected the 46th US president and the public announcement that a COVID-19 vaccine had proven to be 90% effective in late-stage trials, it is easy to forget that exactly eight months earlier, the stock market seemed to be in "free-fall" as we witnessed the stock market crash of 2020. On March 9, 2020, the Dow fell a record 2,013.76 points to 23,851.02. Only days later, on March 12 and March 16, the Dow experienced two more record-setting point drops.

In the immediate wake of the gut-wrenching market declines that occurred in March 2020, the valuations of some companies, particularly those in sectors where businesses were forced to temporarily suspend or dramatically reduce operations and were not easily adaptable to social-distancing mandates and concerns, shrank by more than 80% from their 52-week highs. As such, many activist investors had their hands full in dealing with their existing positions, some of which were then significantly underwater.

Lack of Historical Precedent of Activist Investors Waging Campaigns in the Wake of a Global Pandemic and Related Global Economic Shutdown

Even among the most experienced activist investors, none could claim any experience waging an activism campaign in the wake of a global pandemic of the scale of COVID-19 and the related global economic shutdown.

[7] On November 9, 2020, the first trading day after former US Vice President Joseph R. Biden was projected to have been elected the 46th US president, the S&P 500 closed at 3,550.50 and the Dow 30 closed at 29,157.97. The record closing high for the S&P 500 is 3389.78 set on August 18, 2020 and the record closing high for the Dow 30 is 29,551.42 set on Feb. 12, 2020.

Activist Investors Faced Challenges in Coordinating Their Engagement With the Company's Board and Management Team

In recent years, many activist investors have been very successful in being able to constructively engage with company boards and management teams, at times outside of public view, and communicate a convincing argument as to why their ideas make sense for the company and would lead to enhanced shareholder value. In some cases, such constructive engagement has led to some activism campaigns ending before they even got publicly announced or, even if they got publicly announced, ending well in advance of a shareholder vote. To that end, as part of a company's activism preparedness plan, companies are often advised to plan for that engagement and identify in advance who would be the most effective company representatives, and coached on how to make those engagements as constructive and productive as possible.

During the 2020 proxy season, activist investors had to confront the possibility that it would likely be more challenging to engage with boards and/or management teams when much of the world was not only working from home, but also was still in the early stages of finding their "sea-legs" in the evolving work from home environment. More problematic for such engagements was that boards and management teams had their hands full focusing on the health and safety of their employees, staying afloat, preserving and ensuring access to liquidity, discerning how best to pivot the company's business model, preserving the overall health of the business, and ensuring the company's ability to rebound from the COVID-19 pandemic.

Activist Investors Faced Challenges in Engaging with Investors

Activist investors also had to contend with the logistical challenges of engaging with investors in a virtual meeting environment. Typically, activist investors would make the rounds with a company's institutional investors to build support for their ideas and campaign and, at some point, after a proxy statement was filed with the SEC, solicit a proxy card. All of that would now need to be accomplished in a socially-distant manner, which meant holding such meetings virtually. After more than eight months of participating in multiple virtual meetings every business day, many of us may forget how alien the concept of virtual meetings was at the beginning of the COVID-19 pandemic.

Activist Investors Faced Challenges in Pursuing a Proxy Contest at a Virtual Shareholders Meeting

During the 2020 proxy season, more companies held a virtual shareholders' meetings than ever before. It is likely that this trend will continue and it also likely that the infrastructure for virtual meetings will continue to improve as we look towards the 2021 proxy season. While virtual shareholders' meetings and waging a proxy contest at a virtual shareholders' meeting may become the new "normal," prior to the 2020 proxy season, virtual meetings were still an evolving practice and there was not much historical precedent for proxy contests at virtual meetings prior to the 2020 proxy season.

Possibility that Activist Investors Would Have Been Perceived as 'Tone-Deaf' to the Pandemic and What Companies Were Dealing With If They Waged a Campaign

There was also the possibility that activist investors would have looked "tone-deaf" waging campaigns against companies already facing unprecedented challenges due to the COVID-19 pandemic and related global economic shutdown. Clearly, in the early months of the COVID-19 pandemic, the optics were not favorable for an activist investor to criticize a company's performance and suggest shareholder value enhancement options when, in some cases, the company's ability to stay afloat long enough to persevere through the pandemic and rebound was in question.

Activist Investors Had Limited Ability to Credibly Criticize Company Performance and Management's Response to COVID-19

While not impossible, activist investors would have also found it difficult to criticize company performance when the playing field and global macroeconomic environment had so radically and unexpectedly shifted in a way that no company could ever have anticipated and planned for. It would also be difficult for any activist investor to attempt to credibly argue that it had a better plan for managing through the COVID-19 pandemic than the company's incumbent board and management.

Activist Investors Had Limited Ability to Articulate a Credible Strategy for Enhancing Shareholder Value in the Immediate Aftermath Of COVID-19 as Various Popular Value Enhancement Options Fell Out of Favor

Activist investors typically have an investment thesis that they believe shows the potential for unlocking value at a particular company. To that end, the activist investor identifies a lever to unlock shareholder value that they believe, through engagement with a company's board and/or management or a public campaign, is accessible in the near-term. While clearly activist investors learned a great deal during the 2020 proxy season, prior thereto, there was absolutely no playbook for executing an activist investor-driven investment thesis in the wake of a global pandemic like COVID-19 and a related global economic shutdown.

As companies struggled to stay afloat and preserve their ability to rebound from the COVID-19 pandemic, many of the strategies activist investors typically use to enhance shareholder value at their targets, such as unlocking the sum-of-the-parts value of company operations via asset sales or spinoffs, or seeking to monetize non-core assets may have been difficult for activist investors to credibly present as something that companies, rather than focusing on their response to the pandemic, should turn their attention to.

During the 2020 proxy season, activist investors may have also found it difficult to push some of the more popular activist investor-driven initiatives such as stock buybacks or special cash dividends. While returning cash back to stockholders through stock buybacks and/or special cash dividends may be coming back into vogue, they were not particularly fashionable during the 2020 proxy season. For companies that benefited from the US government's $2.3 trillion economic stimulus package, companies were prohibited from engaging in stock buybacks through September 2020.

Possibility that Activist Investor-Driven Board Changes Would Not Have Been as Attractive to Investors as They Would Be in the Absence of the COVID-19 Pandemic

One of the most frequent demands by activist investors is for companies to refresh their boards. The possibility that an activist investor would have the support of investors for board refreshment provides the activist investor with a significant amount of leverage to place pressure on the company's board and/or management team to engage with the activist investor and consider its ideas for enhancing shareholder value.

During the 2020 proxy season, activist investors had to consider whether investors would be as supportive of replacing directors in the immediate wake of the COVID-19 pandemic as they otherwise would have been. At a time when companies had significant need for continuity, institutional memory, and experience to help them navigate through an unprecedented crisis, activist investors had to consider that board refreshment may not have been very appealing to some investors.

HOW COVID-19 COULD BE A CATALYST FOR SHAREHOLDER ACTIVISM DURING THE 2021 PROXY SEASON

Notwithstanding that the COVID-19 pandemic was clearly a limiting force on shareholder activism during the 2020 proxy season, as we look toward the 2021 proxy season, there are numerous reasons to believe that the COVID-19 pandemic could be a catalyst, in numerous ways, for driving shareholder activism, including the following:

- Plethora of companies, particularly small-caps, with stock prices that have not recovered from the March 2020 COVID-19-driven market crash in the way that many large-caps have recovered
- COVID-19 provides activist investors with an opportunity to drive a narrative for why activist-driven change is needed at a company
- COVID-19 has revealed new paths for shareholder value enhancement in the "new normal"
- Opportunity for activist investors to pressure weakened companies to sell to stronger players and M&A activity is likely to be bolstered by the surge in SPACS/blank-check companies
- Activist investors may position themselves as "white knights" uniquely suited to rescue the company
- Activist investors may believe that companies will settle to avoid the distraction and expense of a proxy contest

Plethora of Companies, Particularly Small-Caps, With Stock Prices that Have Not Recovered from the March 2020 COVID-19 Driven Market Crash in the Way that Many Large-Caps Have Recovered

While activist investors have shown an increased preference for large-cap companies in 2020, both globally and in the United States and while large-cap activism situations tend to get more media attention than small-cap activism situations, more than half of the companies targeted in recent years, both globally and in the United States, are companies with market capitalizations below $2 billion.[8]

While both the Dow 30 and S&P 500 indices surged forward following the projection that Joseph R. Biden had been elected the 46th US president and the announcement that a COVID-19 vaccine had proven to be 90% effective in late-stage trials, small-caps still lag significantly behind large-caps. As of November 12, 2020, the Russell 2000 is only up 3.45% year-to-date, while the S&P 500 is up 10.11%. As such, particularly with respect to the universe of small-cap companies, it is likely that, from a valuation perspective, activist investors will find no shortage of companies that may be attractively priced.

COVID-19 Provides Activist Investors With an Opportunity to Drive a Narrative for Why Change Is Needed

COVID-19 provides activist investors with an opportunity to drive a narrative that illustrates their pre-pandemic concerns with companies they target. Even if the COVID-19 pandemic and government-mandated business closures that followed in response thereto have resulted in an unprecedented crisis of such an epic scope that would have been impossible for any company to anticipate and plan for, some activist investors may believe that the company's performance during COVID-19 provides ample proof points supporting their case for change. Activist investors may attempt to drive the narrative that, given the company's performance since the onset of the COVID-19 pandemic, particularly when compared to industry peers, the company needs to enhance the composition of its board of directors and its leadership if it is going to have any chance of rebounding from the COVID-19 pandemic. In the wake of COVID-19, an activist investor seeking to build a narrative of why activist investor-driven change is needed at a

[8] Activist investor Insight

company may look to highlight the following:

- Lack of a strong, crisis-ready, and resilient board of directors and management team
- Missing functional competencies among the company's board of directors and management team
- Failure of the company to successfully and quickly pivot its business model and strategy in response to the challenges posed by the COVID-19 pandemic, particularly when compared to industry peers
- Flaws in a company's strategic plan and business model, particularly in light of the pandemic-driven shifts towards digitally-centered contactless commerce
- Failure of the company to reduce its cost structure in the wake of COVID-19 driven changes (e.g., less than optimal real estate footprint in a work from home and digital commerce centered environment)
- Failure of the company to manage its supply chain to address quick-moving shifts in customer demand and reduce dependency on particular geographic regions
- Failure of the company to thoughtfully and responsibly manage and address liquidity issues caused by the COVID-19 pandemic
- Failure of the company to develop and publicly articulate a strategy on how the company will be able to persevere through the pandemic and rebound
- Failure of the company to develop and publicly articulate a strategy for successfully restarting once government mandates on business closures and social distancing began to be loosened
- Failure of the company to develop and publicly articulate a credible strategy for enhancing shareholder value in the wake of the COVID-19 pandemic
- Disconnects between executive compensation and the company's share price performance highlighted by the COVID-19 pandemic
- Failure of the company to develop and implement policies and protocols that ensure the health and safety of the company's human capital while enabling the company to function effectively and service its customers

COVID-19 Has Revealed New Paths for Shareholder Value Enhancement in the 'New Normal'

Since the onset of the COVID-19 pandemic, companies have had to pivot their business models and reimagine their businesses in ways that allow them to service their customers in the "new normal" and take into account a new paradigm of work from home, virtual schooling, home as the epicenter of daily life, accelerated shifts to ecommerce and touchless transactions, government-imposed social distancing, and wariness for public spaces and crowds, particularly indoors.

As companies become more creative in reimagining their businesses and developing new ways of conducting business that provide alternative revenue streams, they also highlight for activist investors new paths for shareholder value enhancement that other companies may not be pursuing. The hospitality industry provides an obvious and relevant example, given how much interest activist investors have shown in targeting hospitality companies in recent years. When government mandates shuttered restaurant dining rooms across the country at the onset of the pandemic, restaurants were forced to pivot to make up for the loss of revenue from in-restaurant dining. Many restaurants, to the extent their business lent itself to carry-out, pivoted to online orders, home delivery, takeout, and curbside pickup. Other restaurants, particularly those with larger kitchens and with menus not as easily adaptable to takeout and/or delivery, developed "ghost kitchens" where, effectively, a fast-casual restaurant was "secreted" in the kitchen of a sit-down casual dining restaurant. In some cases, the menu offerings for the "ghost kitchen" have no obvious nexus to the menu of the restaurant in which it is housed. In complete 20/20 hindsight, you can imagine more than a few hospitality company executives wondering why they had not attempted to develop this alternative revenue stream pre-pandemic. In any case, this is an example of a new shareholder value enhancement path that was not as obvious pre-pandemic as it is today. For an activist investor targeting a publicly-traded hospitality company, such as a casual dining chain, "ghost kitchens" and the additional revenue that can be derived therefrom are just one path for shareholder value enhancement brought into sharper focus by the COVID-19 pandemic.

The retail industry is another industry where the pandemic has highlighted for activist investors new paths for shareholder value enhancement. The COVID-19 pandemic has bolstered the case for retailers to develop and/or enhance their omni-channel capabilities, including ecommerce, curbside pickup, and same-day delivery. In the wake of the COVID-19 pandemic, an activist investor may demand that a retailer adopt and implement additional e-commerce and omni-channel capabilities and adopt a better strategy for driving a higher percentage of revenue from channels not dependent on consumers entering and/or making their buying decisions at physical stores. As more retailers enhance their ecommerce and other omni-channel capabilities in recognition of the accelerated shift away from physical stores to digital shopping, as well as consumers' wariness for crowds and indoor public spaces, an activist investor may also demand that a retailer optimize its physical store footprint. Such a demand can take a number of forms, including a reduction in total physical stores, the closure of lesser-performing physical stores, a reduction in the square footage of various physical stores, a renegotiation of lease payment terms, and/or the relocation of physical stores. Again, there are paths for shareholder value enhancement brought into sharper focus by the COVID-19 pandemic.

Opportunity for Activist Investors to Pressure Weakened Companies to Sell to Stronger Players and M&A Activity Is Likely to Be Bolstered by the Surge in SPACS/Blank-Check Companies

Companies that have had their market valuations significantly reduced, or that have market valuations that lag behind their larger peers, may be perceived as compelling targets for strategic and financial buyers, even if long-term shareholders may resist M&A transactions with prices that leave them significantly underwater.

Some activist investors may believe that, given the substantial impact that the COVID-19 pandemic has had on many industries, there is now a unique opportunity to push for the weaker companies in those industries, particularly those with liquidity challenges, to combine with the stronger companies.

It is also likely that the recent proliferation of SPACS, including those formed by activist investors, will only further fuel activist investors' demands for M&A. Even if the SPAC is not looking to merge with or acquire an already public company, where an activist investor is demanding that a public company pursue some form of "carve-out" or spin-off transaction, the availability of numerous SPACS to participate in those transactions can be expected to be a catalyst for those types of activist investor demands.

Activist Investors May Position Themselves as 'White Knights' Uniquely Suited to Rescue the Company

Some activist investors may attempt to portray themselves as "white knights" seeking to be helpful to the company in its time of need and offering to help the company overcome the crisis. Some activist investors, particularly those that see themselves as more constructivist in nature, may believe that their skillsets and experience at other companies, including those in the same industry, make them uniquely suited to help companies navigate through and emerge from the COVID-19 pandemic. In some cases, companies may welcome that assistance, particularly if the company needs additional liquidity and the activist investor can make such liquidity available. This "selling point" may be very appealing to institutional investors familiar with a particular activist investor, its experience in a particular industry, and its track record in helping to drive turnarounds

Activist Investors May Believe that COVID-19 Will Cause Companies to Settle With Them

In any given year, only a small percentage of proxy contests are decided by a shareholder vote as many companies make concessions that result in the activist investors agreeing to withdraw their campaigns.[9]

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[9] FactSet Research, Inc.

In 2020, there were only 16 contested shareholders' meetings that resulted in activist investors gaining board seats, compared with 80 settlements with the activist investors that resulted in activist investors gaining board seats.[10] Out of the 168 directors placed on company boards by activist investors, 135 were placed on boards pursuant to settlement agreements with the activist investors and only 33 were placed on boards via a shareholder vote.[11] Activist investors may believe that, given that many companies remain focused on staying afloat, addressing their liquidity needs, the overall health of their business, and their ability to persevere through, and rebound from, the COVID-19 pandemic, they may be more likely to settle with the activist investor to avoid a proxy contest and its related costs and disruption.

OTHER FORCES THAT COULD DRIVE SHAREHOLDER ACTIVISM DURING THE 2021 PROXY SEASON

In addition to the COVID-19 pandemic, there are other forces at play that will also likely drive shareholder activism during the 2021 proxy season, including the following:

- Activist investors don't get paid to "sit on the sidelines" and there is likely pent-up demand by activist investors who held back during the 2020 proxy season
- Relative to other investment opportunities, shareholder activism remains very attractive for investors seeking yield
- Activist investors will continue to benefit from a highly conducive regulatory environment
- Value enhancement initiatives like stock buybacks and special cash dividends will again be in vogue
- Evolving acceptance of the "new normal" and increased comfort in conducting an activism campaign in a socially-distant environment
- Enhanced infrastructure for conducting proxy contests at virtual shareholders' meetings
- COVID-19 has caused companies to be less prepared to engage with and respond to activist investors

Activist Investors Don't Get Paid to Sit on the Sidelines

As noted above, as of the third quarter ended September 30, 2020, activism activity was clearly down in 2020 when compared to the same period in 2019.[12]

Regardless of whether activist investors are able to correctly identify targets with substantial potential upside and regardless of whether the traditional activist investor playbook is workable in the current environment, it is important to note that activist investors get paid fees to develop and implement activist investor strategies, not sit on the sidelines.

Activist investors may be reluctant to have to explain why they are not putting their clients' money to use and have to answer the question, "If not now, when?" Activist investors, concerned with preserving their credibility as an activist investor, may also be reluctant to be accused of missing out on investment opportunities, particularly if their competitors are willing to take positions.

Relative to Other Investment Opportunities, Shareholder Activism Remains Very Attractive for Investors Seeking Yield

With the US Federal Reserve's current and very accommodative monetary policy of keeping interest rates near zero until the economy is able to overcome the effects of COVID-19, relative to other investment

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[10] Activist investor Insight (as of September 30, 2020)
[11] Activist investor Insight (as of September 30, 2020)
[12] Activist investor Insight (as of September 30, 2020).

opportunities, it remains very attractive for institutional investors to allocate a portion of their funds to investment vehicles with an activist investor strategy. It has often been said that activism, particularly large–cap activism, would never have acquired the momentum it has without the support of institutional investors. The expectation that the Federal Reserve is likely to maintain an extremely low interest rate environment can only be expected to further institutional investors' continued willingness to commit funds to investment vehicles with an activist investor strategy.

Activist Investors Will Continue to Benefit from a Highly Conducive Regulatory Environment

Shareholder activism has always benefitted from a highly conducive regulatory environment. Notwithstanding the change in administrations that will occur in January 2021 when President-elect Biden takes office and the shift from a Republican Party-led executive branch to a Democratic Party-led executive branch, it is not likely that we will see any change in the regulatory environment that will significantly impact shareholder activism in the 2021 proxy season. Even past the 2021 proxy season, and taking into effect that we will likely have different parties controlling the White House and the US Senate, it remains unclear, particularly given other legislative and regulatory priorities such as those that address the impact of COVID-19, that any material change in the laws, regulations, and rules that impact shareholder activism will likely gain any traction over the next 12–18 months.

Value Enhancement Initiatives Like Stock Buybacks and Special Cash Dividends Will Again Be in Vogue

During the 2020 proxy season, it was difficult for activist investors to push some of the more popular activist investor-driven initiatives such as stock buybacks or special cash dividends. With the ultimate duration and impact of the COVID-19 pandemic extremely uncertain, and with much of the United States and the world in a state of lockdown for most of the spring, companies and investors alike were very focused on preserving and shoring up access to liquidity. The idea of returning what some may otherwise perceive as excess cash, and others regard as "rainy-day" funds, quickly became unfashionable. Many companies were concerned that even those "rainy-day" funds would not be sufficient to get them through what would more aptly be described as at least a "tropical cyclone." In addition, the $2.3 trillion economic stimulus package that US President Donald J. Trump signed into law on March 27, 2020, the largest federal stimulus package in US history, contained a provision that prohibited companies that tapped into the fund to engage in stock buybacks through the end of September 2020.

As we look towards the 2021 proxy season, with the initial shock of the COVID-19 pandemic behind and companies having improved visibility on their liquidity needs, it is likely that activist investor demands like stock buyback and cash dividends will again be back in fashion, particularly at companies that have been able to weather the COVID-19 pandemic without much need to tap into their cash reserves.

It is also possible that, as the Federal Reserve maintains interest rates near zero, that activist investor will look for companies to reassess their capital structure and consider borrowing more to fund stock buyback and special cash dividends.

Evolving Acceptance of the 'New Normal' and Increased Comfort in Conducting an Activism Campaign in a Socially-Distant Environment

As discussed above, during the 2020 proxy season, activist investors were presented with numerous logistical and practical challenges in waging an activist investor campaign, including the following: (i) challenges engaging virtually with company boards and management team, (ii) challenges engaging virtually with investors, and (iii) challenges conducting a proxy contest at a virtual shareholders' meeting. In complete 20/20 hindsight some eight months later, those challenges look much less daunting. It is not hard to imagine that over the past eight months, there have been hundreds of meetings between company representatives and activist investors conducted over Microsoft Teams, Webex, Zoom, and/or other similar virtual meeting platforms and all parties have now acquired their "sea-legs" for conducting such meetings.

Enhanced Infrastructure for Conducting Proxy Contests at Virtual Shareholders' Meetings

During the 2020 proxy season, the experience of many companies and activist investors with virtual shareholders' meetings was very limited. While the infrastructure for conducting such meetings existed, it was still evolving and there was limited capacity to accommodate all the companies that wanted to hold a virtual meeting for the first time in their history. In addition, there was little precedent for conducting a proxy contest at a virtual shareholders' meeting and numerous logistical questions abounded as to how certain mechanics would be handled. As we look toward the 2021 proxy season, those challenges look much less daunting and the infrastructure for virtual meetings, whether uncontested or contested, appears to be firmly in place and will likely continue to evolve between now and the 2021 proxy season.

COVID-19 Has Caused Companies to be Less Prepared to Engage With and Respond to Activist Investors

If many companies were "sitting ducks" prior to the COVID-19 pandemic and were reluctant to acknowledge how vulnerable they were to an activist investor and how unprepared they were would an activist investor seek to engage with them, the pandemic, while unprecedented and impossible for companies to anticipate, has likely only exacerbated such vulnerabilities.

Given that the primary focus of many companies over the past eight months has been on preserving liquidity, staying afloat, pivoting the company's business model to respond to changes wrought by the COVID-19 pandemic, and the overall health of their businesses, it is likely that preparing for shareholder activism and developing "break-glass" plans for how to respond to an activist investor were not high on the priority lists of many companies.

HOW A COMPANY COULD BE VULNERABLE TO AN ACTIVIST INVESTOR IN THE WAKE OF COVID-19

An activist investor does not target a company just because the company is vulnerable. As noted above, an activist investor must first determine (i) that there is an opportunity to generate an outsized return because the company is undervalued by the financial markets relative to its intrinsic value or potential for growth or value enhancement, and (ii) that there is a lever the activist investor can access that will unlock shareholder value. If a company meets those two criteria, it may be an attractive target for an activist investor. Thereafter, the activist investor needs to determine how vulnerable the company is to an activist investor seeking to be a catalyst for change.

Many companies were already vulnerable to activist investors pre-pandemic due to the following:

- Poor stock price, operating, and/or financial performance, particularly compared to peers
- Perceived inability to create shareholder value without meaningful change
- Missteps by the company's management team and the perception that the company's management team is unable to execute
- The management team's inability to articulate a strategy on how the company will drive shareholder value creation
- Executive compensation not sufficiently aligned with performance
- Lack of attention to environmental, social, and governance (ESG) issues
- Lack of confidence by investors in the company's board of directors and/or management team

COVID-19 has not only exacerbated pre-pandemic vulnerabilities for some companies, but it also provides activist investors with an opportunity to illustrate their pre-pandemic concerns with those companies. In the wake of COVID-19, an activist investor seeking to build a narrative of why activist investor-driven change is needed at a company may look to highlight the following vulnerabilities:

- Lack of a strong, crisis-ready, resilient board of directors and management team
- Voids in functional competencies among the board/management that have been revealed by the COVID-19 pandemic
- Missteps by the company in how it responded to the COVID-19 pandemic
- Flaws in a company's strategic plan and business model, particularly in light of the pandemic-driven shifts towards digitally-centered contactless commerce
- Failure of the company to successfully and quickly pivot its business model and strategy in response to the challenges posed by the COVID-19 pandemic, particularly when compared to industry peers
- Failure of the company to reduce its cost structure in the wake of COVID-19 driven changes (e.g., less than optimal real estate footprint in a work-from-home and digital commerce centered environment)
- Failure of the company to manage its supply chain to address quick-moving shifts in customer demand and reduce dependency on particular geographic regions
- Failure of the company to thoughtfully and responsibly address liquidity issues caused by the COVID-19 pandemic
- Failure of the company to develop and publicly articulate a strategy for successfully restarting once government mandates on business closures and social distancing began to be loosened
- Failure of the company to develop and publicly articulate a strategy on how the company will persevere through the COVID-19 pandemic and rebound
- Failure of the company to develop and publicly articulate a credible strategy for enhancing shareholder value in the wake of the COVID-19 pandemic
- Failure of the company to develop and implement policies and protocols that ensure the health and safety of the company's human capital while enabling the company to function effectively and service its customers
- Disconnects between executive compensation and the company's share price performance highlighted by the COVID-19 pandemic

In addition, as noted above, the COVID-19 pandemic has caused many companies to become more creative in reimagining their businesses and developing new ways of conducting business and alternative revenue streams in the "new normal." However, these innovative and resourceful companies have also highlighted for activist investors new and novel paths for shareholder value enhancement that other companies have not pursued. There may be rational explanations why some of these pivot strategies cannot be applied universally, but the onus will be on the company to pre-emptively communicate clearly to its investors, like with most untaken paths for shareholder value enhancement, why some of these pivot strategies are not practical for the company to pursue. In the absence of such a pre-emptive explanation, we should expect an activist investor to raise a company's failure to pursue one of these pivot strategies as a criticism and include it within its narrative of why activist investor-driven change is needed at a particular company.

WHAT TO EXPECT FROM ACTIVIST INVESTORS DURING THE 2021 PROXY SEASON

While the US presidential vote remains to be certified, President-elect Biden will be inaugurated on January 20, 2021 as the 46th US president and, thereafter, we will have a new administration in office overseeing the executive branch of the US government. At the same time, the COVID-19 pandemic continues to cause turmoil as it surges across the United States. As the United States surpasses 11 million COVID-19 cases and approaches 250,000 deaths caused by COVID-19 and numerous states set daily records for new cases and hospitalizations, there are news reports that some states and/or locales may revert to some version of the restrictions that were put in place last March to stem the spread of the COVID-19 virus and "flatten the curve." Already, we have seen the United Kingdom (UK) institute a second national lockdown that will continue at least until the end of November after the UK passed the milestone of one million coronavirus cases. We also have the recent news that two COVID-19 vaccines have proven to be effective in late-stage trials and may be widely available by the spring of 2021. Even if effective COVID-19 vaccines are able to be made widely available by then, it remains unclear when we will be on path to some semblance of normality and whether that will be before 2022.

It is important to note that, in the context of the uncertainty and turmoil discussed above, many activist investors have already selected the companies they plan to target during the 2021 proxy season and have already familiarized themselves with the requisite deadlines for submitting to such companies an advance notice of nominations and/or shareholder proposal. Activist investors may still be in the process of recruiting nominees for possible slates, but unless a company has a particularly early advance notice deadline, activist investors still have plenty of time to complete that process. The larger point is that between now and the end of the year, activist investors will have a fairly clear idea of the companies they plan to target during the 2021 proxy season. However, how current events between now and then impact an activist investor’s plans remains uncertain. As noted above, because COVID-19 was declared a pandemic in March 2020, well after most activists would have selected their targets for the 2020 proxy season, the overall impact of COVID-19 on shareholder activism was lessened. Notably, unlike with respect to the 2020 proxy season, activist investors currently planning for the 2021 proxy season are making those plans aware of the existence of the COVID-19 pandemic and its implications and having to anticipate and incorporate into their plans the possibility that, even if the current case surge is reversed and further extended lockdowns are avoided, the COVID-19 pandemic is not likely to materially subside between now and the end of the 2021 proxy season.

Mindful of the above context, this is what we would expect to see from activist investors during the 2021 proxy season.

- Activist investors won’t sit on the sidelines
- Activist investors will adapt to the “new normal” and will become very comfortable in conducting an activism campaign in a socially-distant environment
- COVID-19 is not likely to have the restraining impact on shareholder activism it did in 2020
- Activist investors will continue to benefit from a highly conducive regulatory environment
- Activist investors will be cautious and selective in choosing and engaging with targets
- Activist investors may seek to retain more optionality on whether to pursue a campaign such that they are better positioned to abandon their campaign if external events impede their investment thesis or the feasibility of a campaign
- To preserve optionality, activist investors will seek to engage with companies behind the scenes and in a less public manner which is easier to accomplish with large-cap targets since the filing of a Schedule 13D may not be required
- Large-caps will continue to represent a larger percentage of the companies targeted by activist investors
- Small-caps will likely continue to represent well in excess of a majority of the companies targeted by activist investors
- Activist investors may avoid sectors not adaptable to conducting business in a contactless environment
- Activist investors will drive narratives around company performance in response to the COVID-19 pandemic, particularly in comparison to peer companies in their industry, and whether the company has a sufficiently resilient board and management team capable of pivoting in times of crisis
- Activist narratives making the case for activist-driven change are likely to include more arguments focused on the company’s handling of ESG issues, particularly environmental and social issues such as climate change and racial equality
- Related to being in a position to credibly highlight how the company has handled ESG issues, activist investors will be under more pressure to propose diverse slates of director nominees, particularly if the board changes they are pushing for would otherwise reduce a board’s diversity

- Activist investors will present demands for value enhancement that would not have been presented in the absence of COVID-19
- M&A (whether sale of the company or sale or spin-off of a business) will likely be the dominant demand by activist investors
- Value enhancement initiatives like stock buybacks and cash dividends will again be in vogue
- Possibility for SPACS to drive some M&A demands, particularly spin-off and "carve-out" demands
- Virtual shareholders' meetings, whether contested or uncontested, will be the prevailing practice for most public companies which will also have the added benefit of enhancing retail investor voting turnout and participation

STEPS TO AVOID BEING A 'SITTING DUCK' FOR AN ACTIVIST INVESTOR DURING THE 2021 PROXY SEASON

While the COVID-19 pandemic was certainly a limiting force during the 2020 proxy season, we would not expect that to be the case during the 2020 proxy season even as the COVID-19 pandemic shows no signs of abating in the near-term. Activist investors have now had eight months to acquire their "sea legs" and recalibrate their playbook for the evolving "new normal" and, unless the environment changes in a way not currently anticipated, it is likely that many activist investors will not be hesitant to wage an activism campaign in whatever "new normal" we find ourselves in during the 2021 proxy season.

A company's experience in traversing through, and pivoting its business in response to, the COVID-19 pandemic, had made many companies more vulnerable to activist investors by providing case studies that illustrate an activist investor's case for why change is needed at a company.

Further, COVID-19 has revealed new paths for companies to enhance shareholder value as companies reimagined their business models, pivoted in response to the COVID-19 pandemic, enhanced their omni-channel capabilities, and developed new revenue streams, many centered on a new economy approach. Many of these paths to enhance shareholder value existed pre-pandemic, but were not in as sharp focus as they are now. Companies that were not as successful in pivoting their business models as other in their industry have done should expect that they will be criticized.

While activist investors tend to center their campaigns on economic issues and not ESG issues, given how much environment and social issues have moved to the forefront of the national discourse this year, companies should expect activist investors will use these issues to help them drive their narrative for why the company is in need of activist-driven change.

It is also likely that the recent proliferation of SPACS, particularly SPACS formed by well-known activist investors, may be a strong catalyst for increased shareholder activism during the 2021 proxy season, particularly where an activist investor is demanding that a company pursue some form of carve-out or spin-off transaction to unlock shareholder value.

While the primary focus of many companies in the near term will likely be on continuing to persevere through the COVID-19 pandemic and address the challenges created by the pandemic, companies should also anticipate that activist investors, in addition to identifying opportunities that have little nexus to the COVID-19 pandemic, will see some of the disruption and turmoil caused by the COVID-19 pandemic as having also created opportunities where they can drive change and unlock shareholder value. Accordingly, companies looking to prepare themselves for the possibility that they will be targeted by one or more activist investors during the 2021 proxy season should consider taking the following actions:

- Assemble an activism response team (e.g., counsel, financial advisor, PR, proxy solicitor)
- Enhance processes to receive early warning of an activist investor targeting the company
- Enhance processes to receive early warning of an activist investor targeting the company (e.g., stock watch, SEC filings on Form 13F, Schedule 13G, and Schedule 13D, activist investors

attending earnings calls, market rumors, media inquiries)
- Review and analyze the company's shareholder profile on a regular basis
- Identify any activist investors that could be potentially interested in targeting the company
- Monitor activist campaigns against industry peers
- Conduct a comprehensive assessment of the company's vulnerabilities to an activist investor
- Consider enhancing structural defenses, taking into consideration the voting guidelines of the proxy advisory firms and institutional investors
- Consider the need for a "poison pill," either one intended to protect against an unsolicited acquisition of control of the company or to protect the company's net operating loss carryforwards (NOLs) from being limited pursuant to Section 382 of the Internal Revenue Code
- Even if it is determined that a "poison pill" is not currently needed, consider having a "shelf" poison pill prepared, reviewed with the company's board, and ready to be adopted
- Develop and maintain a timetable of key corporate events and deadlines, including for the receipt of advance notices of nominations and shareholder proposals as well as the latest date by which the company needs to hold its annual meeting in accordance with its governing documents and/or state law
- Become intimately familiar with any paths available to unlock shareholder value and be prepared to explain why any of those paths may not be appropriate to consider pursuing
- Be prepared to explain why a sale of the company now would not maximize shareholder value
- Determine whether there are any gaps in critical experiences and competencies on the company's board, particularly in light of the challenges posed by the COVID-19 pandemic
- Anticipate how an activist investor would criticize the company, including its response to the COVID-19 pandemic and its performance in pivoting its business model in light of the challenges posed by the pandemic
- Refine strategic communications to hone key messages on how the company is being impacted by the COVID-19 pandemic and what steps the company is taking to stay afloat, address its liquidity needs, pivot its business, maintain the overall health of its business, and ensure its ability to rebound from the crisis
- Develop a "break-glass" plan for responding to an activist investor targeting the company
- Plan today for how the company would engage with an activist investor targeting the company
- Proactively address market rumors that question the company's ability to survive the COVID-19 pandemic
- Plan investor outreach to assess investor sentiment, gather intelligence, and gain input on the company's current strategy for responding to the COVID-19 pandemic and enhancing shareholder value

Additional Resources

For more information on shareholder activism and steps companies can take to prepare for activist investors, please consult the Morgan Lewis shareholder activism defense webinar series, which is available on demand. Read more about the Morgan Lewis shareholder activism defense practice.

NAVIGATING THE NEXT.

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