CORPORATE GOVERNANCE

In The Era Of Activism

HANDBOOK FOR A CODE OF CONDUCT

2016 EDITION

PRODUCED BY **JAMES J. CRAMER**

Published by

TheStreet The Deal

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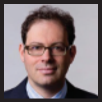

Written By
RONALD D. OROL

Content for this book was sourced from leaders in the judicial, advisory and corporate community, many of whom participated in the inaugural Corporate Governance event, created and produced by Jim Cramer, founder of TheStreet. This groundbreaking conference took place in New York City on June 6, 2016 and has been established as an annual event to follow topics around the evolution of highly engaged shareholders and their impact on corporate governance.

Published by

TheStreet The Deal

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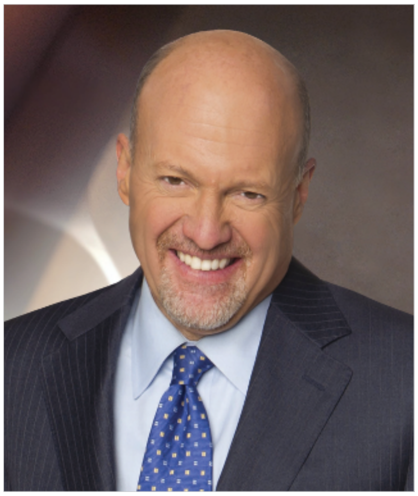
FOREWORD

James J. Cramer



Host, "Mad Money with Jim Cramer"; Co-Anchor, "Squawk on the Street," CNBC; Founder, TheStreet, Inc.

What do you do when an insurgent calls? What do you do when your shareholder base gets restive and demands everything from board seats, to changes in pay, to the firing of the chief executive officer, to the outright sale of your company?

You would think with activism becoming so prevalent, the drill in each of these situations would be obvious. Standard operating procedures would come into play, a set of rules would guide all involved and the challenge would be met with a sophisticated series of parries designed to create the most long-term value for your shareholders—the ultimate responsibility for all the shareholders and their fiduciary shepherds.

The reality is quite different. The vast majority of chief executive officers, members of their boards of directors and advisers approach everything ad hoc. The wheel is re-invented over and over, sometimes in a way that doesn't even work, other times in a way that is so unwieldy as to tip over the entire institution. It's a catch-as-catch-can approach that devolves, sometimes ignorantly, sometimes selfishly and often incoherently into an every-man-for himself situation where value is just as likely to be destroyed as it is to be created.

As someone who has challenged management when I ran my hedge fund, chronicled and reported and opined on the fights in real time, and then, ultimately been in my own share of scuffles in the board room, I know how valuable it is to develop a code of conduct for management to follow. In every single case and role I played I got differing — and often wrong — advice from professionals who hung virtual shingles of certainty over their doors. I have seen boards torn asunder by improper guidance and ill-advised input.

The permutations with activists are myriad. Do you let them in the board room to hear them out? Do you appoint a special committee? Does the CEO or the chairman captain the defense? Do the lawyers, public relations experts and bankers take care of everything to insulate and protect? How can you tell if they have any advice worth taking? When do you just say, "stop wasting my time" and send them on their way?

It was this vacuum of knowledge that drew us at TheStreet and our subsidiary The Deal to fashion a day-long conference meant to develop a definitive code of conduct that will standardize the response to every kind of challenge. In order to get it right, meaning creating value commensurate with the enterprise's capabilities, we brought together experts from every part of the activist food chain to create the fertile conversations that,

FOREWORD

"As someone who has challenged and has been challenged, all I can say is I wish I had this handbook or had held this conference long, long ago. We could have saved innumerable hours, shareholder dollars and our own heartaches had we done so."

in their entirety, allow us to offer you what I think will be the guidebook needed to deal with any situation inside the boardroom.

Unlike other conferences that address this topic, ours came about from a desire to engender a constructive dialogue that can create good will regardless of the ultimate outcome in order to preserve the institution and its ability to generate wealth for all of its stakeholders.

We learned quickly that you can't wait until the insurgent knocks. There are crucial steps that you must take now to be ready for what has become the almost inevitable call. Issues involving governance, pay, objective measures of performance, longevity and secession must all be dealt with well ahead of time to make your company a less desirable challenge for the insurrectionists, many of whom seem to be picking fights just to feather their own press clippings and further their own fundraising. Procedures discussed here can save your enterprise millions upon millions of dollars all the while maximizing shareholder value for all involved.

Once confronted, you need only to turn to the summary of the discussions we encapsulate that will help you arrive at the optimal outcome for your shareholders or your client. We learned very quickly with each panel that there's a right way and a wrong way and plenty of people haven't figured out which is which, including the people you may be paying or those you are offering your services to.

Now, we don't have all the answers, which is why this text will be a living e-book, subject to updates that will keep the insights fresh and the advice cogent and on point. But we do seek to provide the first honest, unbiased code of conduct to which all of the relevant actors can subscribe.

Perhaps most important, if the insurgents won't follow the rules and guidelines set out here then you, again, know what to do in order to keep the enterprise on track for the benefit of all.

As someone who has challenged and has been challenged, all I can say is I wish I had this handbook or had held this conference long, long ago. We could have saved innumerable hours, shareholder dollars and our own heartaches had we done so.

Ultimately we want an open dialogue with you. We will keep track of changes in the literature and recount new forms of challenges to those who sit on boards and suggest the constructive paths leading right up to our second annual conference in New York next year. I may sound like a Pollyanna — or a homer — but I think this living text can create tremendous value as you guide your enterprise or advise your client in the face of shareholder demands that have, alas, become the norm.

INTRODUCTION

Ronald D. Orol

Senior Editor, Activist Investing, The Deal

Activist investing has changed markedly over the past couple of years. For one thing, fund managers in both 2015 and 2016 succeeded in electing more than 40 dissidents a year to corporate boards without launching proxy contests pitting their nominees against management-backed directors.

The phenomenon suggests that companies are often willing to head off battles before they start. But that willingness is not universal. The settlements come with activist hedge funds launching 72 full-blown proxy contests to elect directors at targeted companies in just the first five months of 2016.

That means insurgent funds are on track to meet and possibly surpass the 87 director election battles they launched in all of 2015, according to FactSet.

And as settlements and battles proliferate, targets are getting bigger. This year billionaire raider-turned-activist Carl Icahn launched a campaign at American International Group Inc., Starboard Value's Jeff Smith waged war with Yahoo! Inc. and newbies Par Capital and Altimeter Capital joined forces against United Continental Holdings Inc. All three of those were settled in deals that added dissident directors to corporate boards. From 2009-2015, over 40% of companies in the S&P 500, or 234 corporations, were targeted by activists, according to FactSet.

The business of activism in evolving, but the rationales for insurgent campaigns should be familiar. Targets may be undervalued, ill-managed and run by overpaid or poorly incented executives and their over-tenured, crony directors. Businesses may be ripe to be acquired for a premium or they could be candidates for value-enhancing break-ups. Many investors see unused cash as fuel for stock buybacks and dividends.

When activists descend, executives and directors — often beset with a conflicting set of priorities and a long-ignored institutional investor base — scramble to fashion a response. Should they talk to the agitated investor? Make the CEO available for media interviews? React to personal criticism leveled against top executives? Add new directors? Bolster their stock buyback program? Or settle quietly by adding one or two dissidents to the board?

TheStreet and The Deal sought to answer these and many other burning questions about governance and activism in the 21st Century at a June 6 event titled "Corporate Governance 2016: Shareholder Activism and Value Creation."

INTRODUCTION

"Activism as a strategy is as old as the public markets. It was employed in the past by famed value and investment icons Warren Buffett and Benjamin Graham at various times in their careers."

The conference brought together Fortune 500 executives, top-tier fund managers, prominent advisers, lawyers, journalists and a judge at the center of the debate. All the participants shared their expert opinions on the subject of governance in the age of activism.

This book condenses all the expert commentary from the conference into a first-ever code of conduct to guide corporate boards and executives in their interactions with insurgent fund managers, other shareholders, proxy advisers and solicitors, public relations firms and the media. The following pages represent a roadmap for how to deal with activists and institutional investors and how to better understand which practices will help directors and executives create value for shareholders.

Chapter 1 lists ten actions corporations can take to keep activists away while Chapter 2 examines why it's important not to be a jerk and how a constructive dialogue among directors, executives, activists and other shareholders can help ensure that a fight never takes place. When a fight appears imminent, Chapter 3 explores whether it makes sense to fight over the company's future or avoid months of pain by settling. Chapter 4 delves into the opaque world of shareholder relations and Chapter 5 discusses how technological advancements often mean long-serving corporate directors must be replaced or targeted. Chapter 6 explains why activists have an implicit advantage in the media and what companies can do about it.

In Chapter 7, Trian Fund Management's Nelson Peltz describes Trian's operational style and what makes the firm's strategy unique. On the corporate side, AIG Chief Executive Peter Hancock explains in Chapter 8 how he was able to thwart Carl Icahn's effort to break up the insurance giant. Lessons from his battle may come in handy when an activist is at your doorstep.

We provide three separate must-have checklists — one on what to do before an activist calls, another after the call comes and a third on how to create value. Finally, an activism and governance guide puts a roster of external resources at your fingertips to help you prepare and keep up to date on the latest developments and trends.

One word of warning: Any director who believes his or her company is immune to activism should consider that roughly 25% of all U.S. corporations are dealing with the issue and that activist funds stand ready to unleash a veritable ocean of money on unwary businesses. Insurgent fund managers control a whopping $113 billion, up significantly from the $36 billion they managed in 2009, according to HFR Inc.

Activism as a strategy is as old as the public markets. It was employed in the past by famed value and investment icons Warren Buffett and Benjamin Graham at various times in their careers. It survived the 2008 financial crisis and has returned in recent years with a vengeance. It's an investment style that will likely never disappear. ■

CHAPTER 1

Ten Ways to Protect Your Company from Activists

CHAPTER HIGHLIGHTS

- **Maintain constant communication with shareholders**
- **Hire an effective IR executive**
- **Craft a coherent strategy**
- **Channel your internal activist**
- **Improve your governance**
- **Tie compensation to performance**
- **Continue talking to shareholders about executive compensation plans**
- **Keep proxy advisory firms happy and avoid red flags**
- **Succession planning, succession planning and succession planning**
- **Put skin in the game — a shareholder stake to align directors with activists**

The best way to defend a company against an activist hedge fund is to make sure no insurgent investor ever decides to bother your business in the first place. This chapter sets out ten ideas about what corporations can do beyond meeting profit and revenue targets to keep activists at bay. Knowing what shareholders think about key issues — such as whether they will support the company's executive compensation and M&A plans — goes a long way toward ensuring that investors don't turn against the board and C-Suite executives. And if the two sides aren't on the same page a large negative vote on the CEO's pay plan could be next, followed by an activist hedge fund's director-election campaign.

Maintain constant communication with shareholders. The best way to avoid an activist is through strong performance and on-going conversations with shareholders. Getting to know what shareholders are interested in is vital. In particular, corporate executives and investor relations officials must be prepared to explain to institutional investors why the company can't provide some perks — an expanded capital distribution plan, for example — shareholders are seeking. Susan Salka, chief executive of AMN Healthcare Services Inc. explains her strategy for investor communications: "We go meet with them one-on-one to make sure that we're able to give them color and tell them more about the story and the strategy, but also to listen to them," she said. "It's not always about what are we doing, but what are we not doing, and why maybe a particular path they have in mind we don't believe is the right path. So I think having that constant interactive dialogue is really critical." Talks should take place at conferences and by bringing shareholders into the office for additional meetings and tours.

Hire an effective investor relations official. The IR executive explains the corporation's story to institutional and retail investors. Clifton Robbins, a collaborative activist who often privately urges companies to consider M&A or capital allocation strategies, says he doesn't think many IR people are as effective as they could be. "I find more and more when we're investing in a company, one of the things we tell them is upgrade the investor relations function," Robbins said. "The investor relations person is hugely important in the company. They have to have the ear of the CEO, and must be trusted by the CEO. This is the person who's making sure the stockholders understand the company, who's getting the CEO in front of the large stockholders, who is dealing with the activists and all the owners and I think in many companies this is an under-resourced function."

In addition, IR officials should work closely with the company's corporate secretary to make sure both individuals are on the same page when it comes to governance issues. "The corporate secretary and the investor relations people need to act together because the corporate secretary, at times, oversees some of the governance issues and if they're not communicating properly with the investor relations folks, there can be a disconnect with your shareholders," says Anne Sheehan, governance director at the California State Teachers' Retirement System.

CLARITY ON COMPENSATION: Celgene Corp. CEO Robert Hugin tells TheStreet founder Jim Cramer that corporate officials need to do a better job explaining to institutional investors in one-on-one meetings how compensation packages for top executives are tied to shareholder value.

Craft a coherent strategy. A poorly performing stock coupled with a failure to produce and explain a coherent strategy could make a company a target of activists. Leslie Moeller, global leader at PwC's strategy consulting business, notes that in many cases corporations acquire businesses that "they have no need to be in whatsoever" as they pursue growth. Corporations with multiple business lines that aren't related and don't provide useful synergies to each other could attract an insurgent seeking to break up the business to unlock shareholder value. "Activists are quite good at sniffing out incoherence because maybe it drives poor performance because you spend a lot of capital and energy on forcing things you should not be doing," Moeller says. "For a number of my clients that pressure has been quite useful to getting [strategy] re-aligned in good ways." Consultants should be brought in for project-specific strategic issues — such as supply-chain concerns or branding evaluations — but not for the core business. "Once you get a strategy consultant to tell you what to do with your business it is time for succession discussions because the key role of the CEO is to help the board come up with the big picture," notes Peter Feld, managing member at activist fund Starboard Value LP.

Channel your internal activist. When it seems that shareholders might turn on you it may be time to channel your internal activist — or at least act like an insurgent investor so one doesn't come knocking on the door. Take the case of Thomas J. Quinlan III, President & CEO, R.R. Donnelley & Sons Co. In 2015, R.R. Donnelley, the owner of the Edgar financial-statement wire service company, decided it was going to split into three publicly traded companies — one unit to hold its multichannel corporate-communications operations, another for a financial information service and a third for its traditional printing business. Quinlan says there were no specific activists behind the scenes that drove the strategy — instead it was a perception in the markets that the business was just an "old-line print" company. He wanted it to see how much more it was. "There were no outside parties that came in to cause the initiative that we took," Quinlan says. "I was sort of like the kid at the schoolyard jumping up and down and saying pick me, pick me. I wouldn't have minded if somebody came in just to bring attention." The strategy, Quinlan concedes, did receive some push-back from the board — though directors eventually agreed to the move. "We were basically putting ourselves out of jobs when we were doing this. So I wasn't exactly embraced with the first presentation. I think they [the board] were kind of like, 'what the heck is he drinking?'" Quinlan recalls.

The split took time to complete. Before the board approved the plan it held numerous meetings, where directors agreed to "beat up" the idea again and again. "But spending the time from a governance standpoint, going through it and actually just saying at the end, 'look, this is the right thing to do for shareholders, all stakeholders,' that's how you come about it," Quinlan says. He finally was able to convince the board that the only way R.R. Donnelley could unlock value was if it broke itself up. "If you've got the right people and everybody's ego is in check, you can make the right decisions for everyone," he notes.

Improve your governance. Corporate boards with staggered elections, over-tenured members, audit quality problems and facing an insurrection over executive pay are entrenched, out of touch with their investors and potential activist targets. Dr. Martha Carter, managing director at Teneo Governance, an advisory firm for boards and CEOs says activists are good at connecting the governance dots and if they see underperformance and a combination of these factors they can strike. Carter spent thirteen years at influential proxy advisory firm Institutional Shareholder Services. She contends that governance vulnerabilities can involve audit restatements or even a board where the average director has more than ten years of service. And a similarly long tenure for the chief executive puts the board in an even stronger negative spotlight because of concerns that directors may be overly chummy with the CEO.

There is no shortage of over-tenured directors for activists to target. BoardEx, an affiliate of TheDeal and TheStreet, calculates that there are 1240 independent directors on S&P 500 company boards who have held director positions at a particular company for more than 12 years. Of those, 15 have held their post for 40 years or more, with many additional directors keeping their positions for 20 to 30 years. BoardEx, a relationship mapping service, also notes that the most over-tenured independent directors at S&P 500 companies have held their positions for between 42 and 48 years. "Boards that have a lot of tenure are potentially problematic, but it isn't that simple. You have to take a look at the tenure overlapping with the CEO," Carter says.

Tie compensation to performance. Shareholders typically vote annually on the pay packages for top executives. The requirement was enshrined in law by the Dodd-Frank Act, written in the wake of the 2008 financial crisis. The votes are non-binding so companies technically don't have to do anything when they receive a strong negative vote. However, a shareholder revolt against executive pay can also be embarrassing for boards and executives and can be interpreted as a vote of no confidence in the way management is running the business. A big negative shareholder vote on CEO pay, a few red flags from a proxy adviser and an economic thesis to unlock value may be all that is needed to bring an activist fund into the fray. A company's so-called "say on pay" for CEO compensation can bring with it exactly the kind of attention corporate boards and businesses seek to avoid at all costs.

Explain CEO pay plans to investors. In addition to tying pay plans to shareholder performance, companies need to do a better job explaining their executive compensation to shareholders. "I think investors should almost require that as part of the private one-on-one meetings that we have all the time so that there's a clear alignment between what management's incented to do and what the shareholders are expecting management to do," says Robert Hugin, executive chairman at Celgene Corp.

If a company gets a large — say 30% — vote against its executive pay packages, that plan must be changed or at least explained more thoroughly to disgruntled investors. Otherwise an activist could emerge, especially if share-price performance is lacking.

For example, if compensation isn't fully tied to market results, that needs to be communicated to shareholders to see how they react. André Choulika, the chairman and CEO of biopharmaceutical company Cellectis, suggests that pay plans should account for good execution in terms of operating performance even if market conditions are poor. In other words, he contends that compensation shouldn't be fully tied to share-price performance and shareholders need to understand why.

Keep proxy advisory firms happy and avoid red flags. The largest U.S. proxy advisers, Institutional Shareholder Services and Glass Lewis & Co., issue recommendations on public company governance and their reports carry a lot of weight with institutional investors, including index funds and pension funds. For example, they evaluate a board's response to a low level of support for executive compensation and may issue a negative recommendation on the following year's pay proposal if they believe the company's response is inade-

THE PREMPTIVE SPLIT: R.R. Donnelley CEO Thomas Quinlan describes how he persuaded a skeptical board to agree with his plan to break up the company in order to extract shareholder value — even without an activist at the gate.

quate. A recommendation by ISS against a company's pay package could result in an even larger vote of no confidence in CEO compensation by shareholders the following year. All of this puts additional pressure on the company and could attract an activist looking for a disgruntled shareholder base at an undervalued company. In addition, ISS puts together a QuickScore report on most public companies with a focus on four categories: shareholder rights, board structure, compensation and audit and risk oversight. The report rates companies on a scale of one to ten, with ten representing the worst governance score. A good score — meaning a highly rated governance structure — could help boards and executives stay off an activist's radar. A bad score could have the opposite effect. Companies should be carefully attuned to these reports and any changes to their risk score. "So you put all of that together, and you can tend to look at what an activist might weave together as a story," says Teneo's Carter.

Succession planning, succession planning and succession planning. A company that isn't performing well for shareholders and has an elderly CEO with no serious plan for bringing in new talent could soon face an activist challenger. Such was the case at Forest Laboratories where billionaire activist Carl Icahn launched an insurgency in 2011. The company's founder and CEO, Howard Solomon, had been the top executive for 37 years and was 87 years old. In the years before Icahn's multi-year campaign Forest's share price fell from $75 to roughly $30. In addition, the company had no strategy around capital allocation. Companies that face capital allocation and share price performance problems on their own may avoid an activist. But those that are undervalued, have no serious stock buyback program or dividend and a CEO succession problem become targets. Allergan CEO Brent Saunders argues that it was the lack of succession planning at the top that really put Forest in Icahn's crosshairs. Saunders agreed in 2011 to join the Forest board to be part of the drug-maker's management-backed slate of directors in an initially successful attempt to thwart Icahn's first campaign to elect his own director candidates. Saunders agreed to join the board and defend the company's strategy only if it would start a succession planning committee to identify a replacement for Solomon. Ultimately, Saunders ended up becoming the CEO.

"The succession issue was the issue," Saunders noted. "When there is smoke there is fire. They [activists] see one issue that's problematic and then they tie the kitchen sink to it. Then everything else in that lens looks poor — performance looks worse than it is under the guise of succession planning problems and so forth." Saunders notes that when he met Icahn shortly after becoming CEO, the billionaire activist didn't know much about Forest's strategy. However, Saunders said it didn't matter. For Saunders, Icahn was correct that Forest Laboratories had issues even if he knew little else about the company. "He was right in this instance and was constructively right and forced appropriate succession planning," Saunders said. "He [Icahn] basically said that 'when I see a CEO sitting for 37 years that has poor performance I'm always going to be right and I don't need to know anything else about the company.'"

For Icahn, poor succession planning, lackluster performance and a failure to allocate capital effectively all combined to make the drug company a target. As Saunders suggests, it doesn't matter if you make widgets, pharmaceuticals or microchips, in these kinds of situations, Icahn and other activists will be interested.

Put skin in the game — a shareholder stake to align directors with activists. Activists and institutional investors often raise the question of whether directors and executives at their targeted companies have "skin in the game" — a personal stake in shares that is large enough in their opinion to align their interests with that of other shareholders. When a director or executive doesn't have such a stake activists are quick to pounce. The "skin in the game" issue is one that was discussed throughout The Deal's 2016 governance conference, with various experts on both sides of the battle citing it as a concern. Consider once again the situation at Forest Laboratories, with Carl Icahn aggressively seeking to nominate directors as part of an effort to oust the specialty drug company's 87-year-old founder, Howard Solomon, as CEO. Brent Saunders, then a Forest director, noted that in his later years, Solomon had sold most of his stock, which suggested he wasn't focused on improving share price. "Howard built the company and did a terrific job for 30 of the 37 years he was in charge and perhaps if he had retired five years earlier he could have been one of the best pharmaceutical executives of all time," Saunders said. "In the last few years he felt it was his company even though he had sold most of his stock. He didn't see it that way and the board had to take a hard line and alienate many of his relationships with board members." It's not about friendships; it's about your fiduciary responsibilities.

Sheehan of CalSTRS also believes that more "skin in the game" generally is important. But she acknowledged that directors should be given time to build up a position. "You can't expect someone who is on a board for one year to hold as many shares as someone who has been there for ten years," Sheehan said. "But it helps to have someone in a director position to have the mindset of a shareholder as you are sitting there in the director spot because we expect them to look out for all shareholders not just the ones sitting in the board room."

Corporate executives and other top officials need to be in constant communications with shareholders about their concerns especially if they have complaints about CEO pay. Governance, as we will discuss further in upcoming chapters, is critical. Directors must try have "skin in the game" in the form of a shareholder stake and companies need to constantly be monitoring how they are viewed by the proxy advisory firms — and improve their governance scores if possible.

Businesses with elderly executives and no succession plan are vulnerable as are companies with a discombobulated strategy and numerous unrelated corporate divisions. And when all else fails, sometimes it makes sense to preempt the activist and break up the business, as R.R. Donnelley did. And most important, have a plan in place for dealing with activists so that the board and C-Suite executives aren't caught off guard. This includes making sure the company has contacts with investment banking and legal advisers that can quickly be retained in the event a big-time insurgent targets the company. And if an activist strikes, speak to the insurgent in a constructive manner even if the approach is unusually hostile. As we will learn, a lack of civility could have unintended consequences down the road. ■

CHAPTER 2

How Not to be a Jerk: The Path to a Constructive Dialogue

CHAPTER HIGHLIGHTS

- **Talk to the activist and get together as often as possible**
- **Try to nurture trust between the activist and company**
- **Prevent polarizing the board by maintaining a constructive dialogue**
- **Poison pen letters help attract media attention — but understand that they can have unintended consequences in the boardroom and courts**
- **Put a collaborative activist on the board to block hostile insurgents at the gate**

Despite valiant efforts to keep activist hedge funds away, an insurgent manager has arrived and is at the gate, poison pen letter in hand, agitating for a sale or a major stock buyback or both. What to do? This chapter is intended to provide some insight from a variety of panels about how to interact with insurgent managers, whether they are making their complaints privately or publicly.

Talk to the activist and see if there is common ground. Information is king and activist investors — whether they are established, highly engaged, long-term investors like Nelson Peltz's Trian, or fly-by-night gadflys — often don't have enough. Companies, their boards and investor relations officials must take the time to communicate with activist investors in a constructive manner as early as possible.

The goal is to give the disgruntled shareholder a bit of a window into the company as part of an effort to counter a potential hostile attack down the road. The same goes when it comes to conversations with rank-and-file institutional investors. "The more our clients [corporations] are prepared for those discussions with the information that they have that others [shareholders] can't see… the more you're prepared for that conversation the better it is," explains Colin Wittmer, deals advisory partner and the leader of PwC's U.S. Divestitures unit.

In some cases activists show up at companies and launch public insurgencies with no efforts to talk in advance. However, activist investors have become more willing lately to discuss their grievances in private before taking their show into the public sphere — all of which gives companies a critical chance to make their case before a potentially embarrassing squabble emerges.

"I think the most constructive activists, and most activists will do this these days, will at least attempt a dialog behind-the-scenes," notes David Rosewater, the chief of Morgan Stanley's shareholder activism and corporate defense business. "A lot of them will often not be convinced that it will work, but most activists would rather do things easily than take the hard path, and it makes sense for everyone to go see if there's common ground rather than simply pick a public fight."

The statistics suggest that behind-the-scenes discussions between activists and companies are happening at a large number of U.S. corporations and those talks can remain private if handled properly in a constructive manner. In many cases, the activist campaign may never become public.

Nurture trust between shareholders and directors Joseph Frumkin, partner at Sullivan & Cromwell LLP, contends that a missing ingredient when it comes to relations between shareholders and companies is trust and that lack of trust could lead to an activist investor down the road. Directors, he argues, need to bridge that gap and show shareholders that they are working for their interests. And if directors can convince shareholders to trust them more the result will be fewer activists because investors will realize that boards are working hard to meet their interests.

"Shareholders don't really believe that directors are always being as thoughtful as they should be and always are motivated the way they should be," Frumkin says. "So there's a trust deficiency and I think what we need to do is improve communication between directors and shareholders in order for the shareholders to see, as I think I do in boardrooms, that directors are trying really hard to do a good job."

Poison pen letters help attract media attention — but understand that they can have unintended consequences in the boardroom and courts. Activist investors have long been known to use colorful language in so-called poison pen letters, presentations, news releases and regulatory filings. In 2013, insurgent Dan Loeb said that it was apparent that then-Sotheby's CEO Bill Ruprecht did not "fully grasp the central importance of Contemporary and Modern art" to the auction house's growth

BEHAVE YOURSELF: Travis Laster, Vice Chancellor, Delaware Court of Chancery, urges activists to "act like adults" when they are campaigning at targeted companies or face the consequences in both the boardroom and the courtroom.

strategy. A review of Sotheby's proxy statement, Loeb asserted, "reveals a perquisite package that invokes the long-gone era of imperial CEOs."

Earlier this year, activist Eric Jackson of activist fund SpringOwl Asset Management wrote in a 99-page presentation to Viacom that the media giant isn't "going through a creative lull, it's creatively bankrupt" and that it has a "lackey and overpaid board." In another slide, Jackson refers to Viacom CEO Philippe Dauman, COO Thomas Dooley and owner Sumner Redstone under a heading, "Forget Weekend at Bernie's — For Dauman and Dooley it's been the last few years at Sumner's."

Such letters, full of aggressive and often humorous language targeting boards and top management have been around in one form or another for decades but the artform experienced a renaissance of late in the wake of a string of scathing missives issued first in the late 1990s by Robert Chapman of Chapman Capital LLC and followed famously by Loeb and his Third Point LLC fund.

Nevertheless, these "fight letters" make it difficult — if not impossible — for activists and corporate boards to engage in any sort of civil dialogue once an activist manager is installed in the boardroom. And, in addition, they can have unintended consequences. Travis Laster, Vice Chancellor, Delaware Court of Chancery, urged activists to "act like adults" when they are campaigning at targeted companies. He contends that there are a variety of costs for an activist who essentially is "being a jerk" but has landed himself a position on the company's board.

"Let's assume that you're the activist and you believe that the board, as soon as you got on, started isolating you, formed a committee to freeze you out, they're not listening to anything you say, and you want to come in and say, 'no, this isn't how the things should be going,'" Laster said. "If you've essentially been a jerk you've handed them [company] a good defense which is this guy is not being a constructive board member, he's just being a jerk. So again, I don't view it as a net positive."

Without a civil dialogue, an activist could also get stung in the courts. Laster acknowledged that the aggressive activist approach may make tactical sense initially because it attracts public and media attention and prompts arbitrageurs and other activist-backing hedge funds to invest in their wake (More on that in chapter 6 about the media).

However, he asserts that there could be an unintended long-term consequence of bad manners when an insurgency gets nasty and the battle ends up embroiled in litigation in Delaware Chancery Court.

"When I see the really aggressive language I don't view that as terribly adult and constructive behavior," Laster says. "A lot of this starts with a level of acrimony that is unnecessary, and it taints not only I think the relationship between the activist and people who you may have to ultimately work with in the boardroom, but also if you are unlucky enough to be in litigation it taints your case."

The Delaware court only sees a small percentage of these battles, but in some cases boards seeking to delay and deter activists will change bylaws, issue shares as a defensive posture or take other legally questionable moves. "These situations should be resolved in the ballot box through the voting process and in the boardroom through civil discussion," Laster says. "They get to us when things break down."

He likens the nasty letters and aggressive shareholder presentations to adolescent sparring.

"I know it is a lot of fun to write these nasty letters that say all these bad things about people and have really cute turns of phrase and it's the kind of stuff that when you were in high school you just wish you could have said to that bully," Laster said. "What that does is it has a polarizing effect and when someone like me is looking at it the first question I ask is, 'who is being the adult here?' You want to be the adult — whether it is the person on the insurgent side or the person in the boardroom."

Activists are pushing back on the notion that they aren't civil in their interaction with companies. "If you are going to be juvenile that song is going to get tiring pretty quickly," Jackson says.

He contends that SpringOwl's presentations have resonated with the media and other investors, not because they are nasty but rather because they are full of original research. For example, one presentation on Yahoo! revealed details about a Great Gatsby-themed holiday party hosted by the Internet giant that SpringOwl estimated cost $7 million. The research and report spawned a firestorm of coverage in December 2015 by major outlets including the New York Times, Fortune Magazine, Business Insider and the Daily Mail.

"Some of the points that came out were original research — whether it was reckless spending coming out at Yahoo! or the degree to which Viacom had languished under its current CEO put pressure on both companies and managements to explain themselves," Jackson says.

Fight letters issued by activists don't appear to be on the decline. According to FactSet, there have been 64 campaigns as of June that included a publicly disclosed letter to board/management in 2016 while there were 190 in 2015. A look at fight letters over the years suggests that the number of the missives expected for all of 2016 is likely to come close or match that of 2015. However, even in that environment, insiders contend that the quality of dialogue overall has improved in recent years. That may partly be because companies are taking activists and their suggestions more seriously. They are hiring bankers and consultants to review activist recommendations, actions that add to the constructive nature of the discussions. A company that has hired an investment bank to conduct a strategic review to consider a sale or spinoff will have more credibility with its investor base — and activists — when it decides what to do.

"I don't think there is ever a situation today where an activist will approach a board and truly be stonewalled," Frumkin says. "I think the chances of that are zero out of a hundred. In the old days they [companies] actually wouldn't pay a lot of attention [to the activist]. Today there's no chance it's not going to get a lot of review by bankers and consultants if necessary. People will really think about it."

Put a collaborative activist on the board to block hostile insurgents at the gate. If it is possible for the board to have a constructive dialogue with an activist and the two sides agree on the company's strategic direction it may make sense to add the activist to the board. Having a friendly activist investor on the inside may help to fend off other more hostile activists.

James Snyder, former general counsel at Family Dollar, explains that the discount retailer in 2011 agreed to add Trian Fund Management CIO Ed Garden to its board in a settlement after the fund presented its analysis of the retailer's business. "Trian came in and had a very productive conversation with us," said Snyder. "The initial meeting we had with them, they had their white paper and interestingly the strategy that we had been working on as a company was very much aligned with what the Trian group had also looked at."

Snyder added that Garden became a terrific board member, got to know the company and was "very helpful in suggesting ideas."

However, the greatest help Garden provided to Family Dollar came after the discount retailer's stock price dipped and billionaire Carl Icahn jumped in and began demanding a merger with Dollar General. "His [Icahn's] whole goal was to try to force a deal with Dollar General when we were already in conversations with Dollar General and Dollar Tree and we were close to inking a deal with Dollar Tree," Snyder explains. "His involvement put that deal in jeopardy and we couldn't tell him at the time."

Snyder notes that Garden's presence was helpful because he was integral in convincing Family Dollar's shareholder base — which was now also targeted by Elliot Management's Paul Singer — that a deal with Dollar General was not going to be approved by antitrust regulators in Washington. "I don't know if we could have gotten the deal that got passed eventually done if we had not had Trian on the board," Snyder says. "The fundamental issue was that if we were to accept the Dollar General offer the result would have been a higher price but that deal would never have been approved and it would have been a short-term stock bump and our stock would have ended up probably 20%, 30% or 40% lower than it was."

In a similar situation, Yahoo!'s move to settle with Starboard Value's Jeff Smith in May ensures that whatever results from the Internet giant's auction is respected by the shareholder community. As part of the settlement, Starboard called off its proxy contest and Yahoo! agreed to bring on four of the fund's director candidates, including Smith.

Smith asserts that Yahoo! has been welcoming since his arrival and that the board has been "terrific." In this situation, having an activist on the company's board can convince other shareholders that management is doing everything it can to meet shareholder demands — even if things don't turn out the way investors hope. "Nobody's going to question why they did it, or if they were to walk away, and say, 'we don't feel like this was appropriate, we can do better,' they won't question that because Jeff Smith is there," notes CNBC host David Faber.

Yahoo! is a great example of a situation where even when an activist shows up with a nasty fight letter, relations can improve. Consider that Starboard started its battle with a letter noting in March that Yahoo! had a "dismal financial performance, poor management execution, egregious compensation and hiring practices and general lack of accountability and oversight on the board."

In some cases, however, it may not make sense for the company to add dissident directors to its board. Before such a conclusion can be reached it is essential that executives and board members engage with the activist and provide as much information as possible in as constructive a manner as possible. A hostile, embarrassing public battle can be avoided if some level of trust is developed between the two sides. ■

CHAPTER 3

When To Put up a Fight – and When to Settle

CHAPTER HIGHLIGHTS

- **If they aren't helpful or offer no real insight, don't waste your time**
- **Consider that even one activist on the board could lead to the CEO's ouster**
- **Adding dissident directors may polarize the board; although it may also lead to more robust and productive boardroom discussions**
- **Know your strategy and explain it to shareholders.**
- **Consider the activist's track record**
- **Add management-backed "independent directors" to counter dissident complaints**
- **In some case, go ahead and add a dissident director**

Activists often will give C-Suite officials some time to contemplate their "suggestions" before they shift their campaigns into high gear with a director-election proxy fight. The interval can be as little as a few weeks to as long as 18 months. But it is not unlimited. Typically, activists and other shareholders must make any board nominations at least 90 days before the anniversary of the previous year's annual meeting, but the deadlines vary and sometimes companies will play around with the date to thwart any shareholder nominations.

Companies don't like to talk a lot about the end of an advance notice period because as it approaches executives and boards are often struggling to figure out whether they can avoid a contest.

Investors willing to engage in a proxy contest often nominate candidates for the upcoming annual meeting — usually on or shortly before the deadline — in situations where there isn't a lot of agreement between the two sides over the company's future. When activists formally nominate director candidates, management and directors have to decide — should they fight or settle, perhaps adding some dissidents to their board? And if a fight is necessary — what is the best way to go about it? This chapter seeks to answer those questions.

If they aren't helpful or offer no real insight, don't waste your time. In some situations it makes sense to play defense, particularly when C-Suite officials believe the activist is uniformed and won't add any value to the company. For example, if corporate executives believe two subsidiary units have vital synergies but the activist wants to split them up, it may make sense to respond to an activist's director-election battle head on. This course will depend largely on whether corporate executives and directors also believe the vast majority of their shareholder base will back them up on their assertion. (More on that in Chapter 4)

"In a situation where you run into somebody who has an idea that is just clearly uninformed you sit them down and you try to inform them," explains Colin Wittmer, deals advisory partner and the leader of PwC's U.S. Divestitures unit. "If they just continue to push the agenda I don't think putting them on a board just to put them on a board is the right thing to do. I think you would sit down with them, hear them, inform them, and if you just have to, push them off to the side. Because I don't think putting them in the boardroom is going to be very productive for the company."

Consider that even one activist on the board could lead to the CEO's ouster. Adding one dissident director doesn't sound like it could wreak havoc on a corporation. However, one dissident board member, particularly if he manages or works for the activist fund, can be a big negative for a variety of reasons. If the activist has been agitating for major changes — such as a major shakeup in the C-Suite — an affiliated director could act as a Trojan horse to push out the CEO and force the company in a radically different direction.

Consider a startling statistic from FactSet — Activists joined the boards of 39 companies in 2013 and 44% of those companies changed CEOs within 18 months.

TROJAN HORSE SETTLEMENTS: **Marc Trevino**, partner at **Sullivan & Cromwell**, argues that adding one or two dissident directors to a company's board could lead to the CEO's ouster and an over-weighted shareholder perspective in the boardroom.

"Many institutional investors used to think that adding one or two people on the board was free. Why not try it? How bad could it be? You have a bunch of adults in the room," says Marc Trevino, partner at Sullivan & Cromwell. "I don't think that's the case — it's much more expensive to put someone in the room than people originally thought. The CEO could be terminated and you also have a minority shareholder perspective that is now over-weighed in the board room."

CEOs beware: Activists bill themselves as catalysts able nudge a board in the direction of ousting a long-serving, underperforming chief executive in situations where the board is reluctant to do so. This process works especially well when long-serving directors who have known the top executive and each other for a long time aren't willing to move even though they privately recognize the problem.

Peter Feld, a manager at activist fund Starboard Value, acknowledges that a CEO's ouster is often one of the goals of an activist campaign. Feld notes that over a 12-year period, Starboard's involvement has led to a change in top executives in about half of its campaigns.

"In some cases just as an active or vocal shareholder can provide the catalyst needed to get people in the boardroom who probably know something is not right and that change is likely needed but have been unable to make the change [to take action]," Feld says. "We can provide that catalyst so directors can say, 'it's a shareholder issue and now it's time to make a change.' That catalyst can be very helpful."

Trevino asserts that once an activist is on the board it is hard to undo the damage. "I've never seen that done. The board is polarized. You are operating in this environment," he said.

Bob Evans Farms Inc. is one example of a company whose CEO stepped down shortly after an activist succeeded at getting directors on the board. Activist Sandell Asset Management installed a minority slate of four dissident directors to the restaurant chain's board in 2014 and the company moved quickly to remove and later replace its chief executive. As it was changing CEOs, Bob Evans also carried out another one of the fund's demands — a sale-lease back of 30% to 60% of its real estate in a move that was announced shortly before the 2015 deadline to nominate directors.

However, Sandell is still pushing Bob Evans to hire an investment bank to advise it on separating its sausage and side dish unit, BEF Foods. "We are still waiting for a separation of food business and restaurant business," says Sandell's Richard Mansouri. "That's the last piece of the puzzle."

There is a chance dissident directors will disrupt and polarize the board. In deciding whether to fight or settle companies should consider that in many situations an agreement to bring in a couple dissident directors will create a polarized board split in two teams. "Certain information goes to the directors that the management has the best relationship with and those are usually the ones that have been on the board the longest," says Delaware Vice Chancellor J. Travis Laster. "Meanwhile the activist has directors they brought in and they are sharing different information."

The result, Laster notes, is that everybody is protecting their turf and individual interests and nobody is focusing on long-term shareholder interests. "If you have that situation and have that fact pattern it is high risk for both sides," the judge says. "Someone is not doing the right thing. You don't want a person wearing a black robe to decide what is the right thing. You want to have them decide in a way that is in the best interest of shareholders and the company."

Laster acknowledges that large U.S. corporations are usually better at handling activist situations than their smaller and micro-cap counterparts. "Where I continue to see polarization and nastiness is in the mid-market on down particularly in the small cap space," he notes. "I don't know if there are different dynamics but I think that governance positives tend to get adopted from the top down, with the Fortune 100 and Fortune 500 far ahead in terms of open-mindedness."

In addition, activist-backed directors on a board are also likely receiving different information than everyone else. That's why Starboard Value's Feld urges directors and executives to provide the whole board with raw financial data or at least revenue information categorized in a variety of ways. "The board has very little ability to prepare its own direct financial analysis," Feld says. "As a financial analyst myself, what I can tell you is I can massage a set of numbers to tell you whatever you want them to tell you, and so it's not that they're doing anything wrong, but management will tell the story in numbers that they want to tell."

Know your strategy and explain it to shareholders. Some corporations with dissident directors or insurgents pressing from the outside are under immense pressure to break up. Activists hope to eventually own shares in two publicly traded companies with a combined value substantially exceeding the share price of the current company. In those situations, if management and directors believe that a split-up isn't in the best long-term interests of shareholders it is time to fight. "Some of these businesses are very interrelated," Wittmer points out.

An activist's push to spin off units or separate divisions may be designed in part to create a short term pop in the stock price; the investor may not even care if the break-up works for the companies in the long term. In some cases, shortly after a business is actually divided in two, the activists' cash out leaving behind a world of pain.

Such was the case at Timken, which split off its steel business from its bearings unit under pressure in 2012 from now-defunct Relational Investors. Timken began that process after a nonbinding proposal introduced by Relational and a pension fund, California State Teachers' Retirement System, to have the company consider such a spinoff received the backing of 53% of shares. The endorsement of CalSTRS, a long-term investor in Timken, likely contributed heavily to the investor support and Timken's ultimate move to divide itself in two. Company officials had been against the break-up before the vote, arguing that if there was ever a downturn in steel prices that the bearings side of the business could help offset any losses — and, alternatively, if steel did well that would boost the bottom line.

After the breakup, the newly formed Timken Steel Corp.'s share price has mostly been on a downward trajectory — from roughly $50 a share in 2014 to trade in June at $10 a share — driven by steep drops in steel prices coupled with an oversupply of steel.

"It was a very ill-advised decision. And that's just fine?" asks TheStreet's Jim Cramer. "Is that just fine that that happens? Goldman is fine, Relational is fine, Timken family is rich anyway, is that the way we look at it?"

Consider the activist's track record. Some activists have long records of successfully installing dissident director candidates while others, particularly newly formed funds, do not. Insurgent fund managers with a history of success should be treated more seriously, especially if they have well-known long-term investors in their funds. Starboard Value's Jeff Smith, for example, is an expert at getting dissident director candidates elected. According to Factset, the New York-based insurgent and its predecessor have launched 131 campaigns at 104 companies since 1999. In addition, a large number of Starboard's whopping 62 proxy fights resulted in the installation of dissident directors, suggesting that companies should be careful about picking fights with the fund. Activists received more than 220 board seats in 2015, according to FactSet, with Starboard tied with another well-known activist fund, Elliott Management's Paul Singer, at the head of the pack of a count of dissident director candidates successfully installed at targeted companies.

Most Board Seats Attained by an Activist in 2015

10	Starboard Value's **Jeff Smith**
10	Elliott Management's **Paul Singer**

Source: FactSet Inc.

Starboard's Peter Feld currently sits on the boards of Marvell Technology Group Ltd, Brinks Co. and Insperity Inc., according to relationship mapping provider BoardEx, a service of The Deal. However, over the past few years, Feld has also held seats on the boards of Darden Restaurants, Tessera Technologies Inc., Unwired Planet Inc., Seachange International Inc., CPI Corp. and Integrated Device Technology. "We're not long term directors who are going to be there for the next decade," Feld maintains. "We're there for a period of time to get the board functioning well."

Bringing in new management-backed blood could thwart an activist's advance. If it looks like an activist has the backing of enough shareholders to potentially win a director election contest it might be time to bring on some management-backed "independent directors" as part of an effort to convince institutional investors that the company is open to improvement. For example, newbie activist fund Legion Partners Asset Management LLC in 2015 cancelled a minority-slate proxy contest seeking to put three dissident directors onto Perry Ellis International Inc.'s board after the apparel company installed two high-profile independent directors of their own choosing. One of those directors, Bruce Klatsky, oversaw PVH Corp.'s acquisition of CalvinKlein, and was considered by people familiar with the contest as exactly the kind of top-rated candidate that would have helped Perry Ellis defeat Legion in a director contest had it come to that.

Sometimes it makes sense to settle to add a dissident director or two. Adding activist directors in some cases may be productive. Adding Starboard Value's Jeff Smith to Yahoo!'s board and bringing in Trian's Ed Garden as a Bank of New York Mellon and Family Dollar director appears to have made sense in each those situations.

There are a lot of different dynamics at play in the decision: In addition to whether an activist has a successful track record of proxy battle victories and settlements, companies must consider who the insurgent is specifically seeking to elect. A company is more likely to be amenable to an outside "independent" director both sides agree on than having a top manager from the fund installed onto a newly created strategic review committee.

And if the candidate is an activist-backed nominee, notes Morgan Stanley's shareholder activism and corporate defense chief David Rosewater, the company should consider whether the person is truly independent or someone who will just follow the insurgent's bidding. "Looking at how an activist has behaved in the past will give you some information about how to react to that kind of demand," Rosewater said.

Sullivan & Cromwell partner Joseph Frumkin says it probably makes sense to cut a deal if an activist is willing to settle to add one dissident director onto a company's board. "The negatives to a contest are huge," Frumkin said. "Proxy contests are hugely time consuming and distracting. You have to ask yourself whether you would rather have this six months of intense pain [with a proxy fight] than live with a year or two or three of moderate pain of having this person on the board."

Rosewater contends that one person in the boardroom can do some damage. However, he adds that he or she can also be contained. "There are a lot of different factors that you look at to say OK, 'where are we positioned and how important is it for us to move past this or not?'" Rosewater says.

At Sysco Corp., for example, a decision was made pretty quickly to reach a settlement. Last year, Trian Fund Management's Nelson Peltz and his team were carefully watching U.S. Foods Holding Corp.'s proposed $8.2 billion sale to Sysco, a deal that the investor contends was high-risk and one that was ultimately blocked by Obama administration regulators in June 2015.

Shortly before Trian filed its 13D with the SEC on Aug. 14, 2015, Trian met Sysco's non-executive chairman and its CEO and quickly reached a settlement. "We took them through our white paper and asked for board representaiton. Six days later we were offered two seats on the board," Peltz said. "They were open-minded and accepted that the company had not performed up to expectations and that we could help."

Some companies will decide to settle with activists to avoid bruising contests while others forge ahead to meet dissident director candidates head on. Ultimately, corporate chieftains will choose how to proceed based on whether they believe the activist's agenda conflicts with their vision for the business. Companies with solid strategies and can readily explain how their various divisions function together are often successful at defeating challengers. If the choice is to do battle it may make sense to shake up a boardroom, expand a capital distribution plan or bring in some outside advisers to conduct a strategic review — particularly if the activist is seeking any of these moves. And in other times a settlement may be the best outcome for corporate executives faced with mutinying shareholders and adverse proxy advisory firm recommendations. But remember, one or two dissidents on the board may not seem like a lot but may be enough to oust the CEO and redirect the business. ■

CHAPTER 4

Know Your Shareholder Base

CHAPTER HIGHLIGHTS

- **Understand your adversary**
- **Know when investors want you to settle**
- **Understand which activists prowl in your industry**
- **Determine whether investors seek a break-up**
- **Expect a rapidly transformed shareholder base**
- **Bring friendly shareholders aboard**
- **As the battle unfolds, continue to talk to your long term shareholders**
- **Expect pension funds unhappy with CEO pay to coalesce around an activist**
- **Know which institional investors invest in activist funds**
- **Understand that all activists aren't the same — some are collaborative and others are more hostile**
- **If you have to go to war, then do so knowing which shareholders will be on your side. - Consider the connection between collaborative and hostile insurgents**
- **Evaluate proxy access, majority voting and other governance improvements**
- **Recruit a strong lead director when CEO and chairman roles are combined**

It makes sense for corporate executives and directors to find out as much as they can about the insurgent at their gate. We've talked about how important it is to have a good understanding of the activist investor's proxy fight track record — how often the fund has succeeded in getting directors elected to a corporate board — and its financial viability. In addition, a company should learn as much as possible about its long-term institutional investor base. But beware, once a well-known activist strikes expect a big chunk of the investor base to turn over, revealing a whole new collection of investors with different interests.

Understand your adversary. A new activist fund with little or no track record of getting directors elected and that is experiencing huge redemptions is unlikely to have staying power. A company targeted by this kind of adversary may want to respond in a more aggressive fashion. A company faced with an established insurgent with billions of dollars in assets who has given his investors solid returns over years should try a different approach.

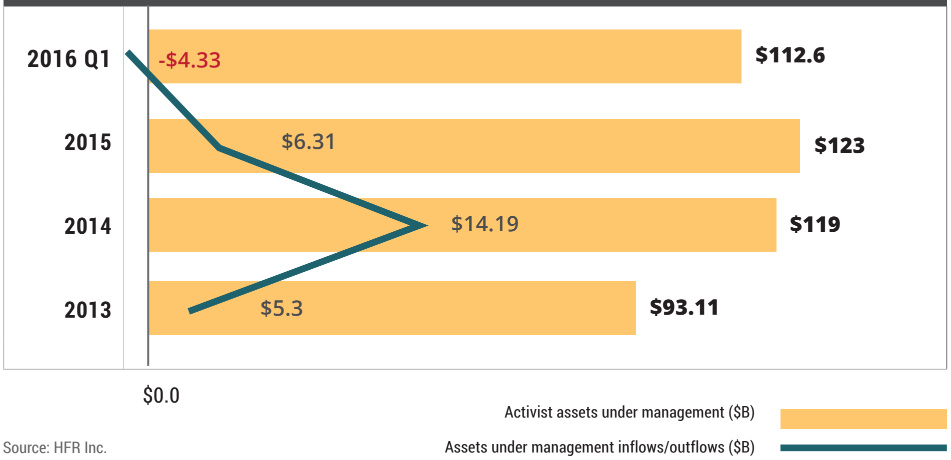
"I think the diligence is going to have to be at the highest level," says PwC's Wittmer. "You just can't take a chance because there are so many newbies in this market now when it comes to activist investing. Hundreds have opened in the last couple of years. So [companies need to know] their real track record and whether they've had redemptions in the past before they put one of them on their board."

Even the largest and most well-known activist is less likely to be on the prowl if its investors are defecting and its returns are subpar. And there are plenty of investor redemptions at U.S. activist funds of late. David Faber, co-anchor of CNBC TV's "Squawk on the Street," notes that 2015 was a terrible year for activist funds as a group.

"I think for the first time the money started to come out or at least stopped going in," Faber says. "There are firms that are definitely seeing some outflows given the performance last year, and that then affects their ability to take large positions, to take risk to a certain extent."

A precipitous stock price drop at Valeant Pharmaceuticals contributed heavily to Pershing Square Capital Management's Bill Ackman, once the darling of the activist investor community, posting an abysmal -20.5% return net of fees for 2015 and -19.7% in early 2016,

Assets Start to Flow Away From Activist Funds



Source: HFR Inc.

according to a February report. However, even with its horrible year, Pershing Square has access to permanent capital through its Amsterdam-listed publicly-traded closed-end fund and will likely strike again.

The first quarter of 2016 represented the first time activist funds as a category experienced outflows in six years. Yet activist funds still controlled a whopping $113 billion in assets, up significantly from the $36 billion they managed in 2009, according to HFR Inc. As an asset class, activist funds are here to stay.

Know which activists' prowl in your industry. Most activist investors specialize in a handful of sectors and corporate boards should keep a close eye on the investors who focus on their industries. Co-founded by Nelson Peltz, Peter May and Ed Garden, Trian Fund Management, for one, primarily invests in three categories of investments: Retail and consumer products; industrials; and non-balance sheet financials.

Other activists like to specialize as well. PL Capital LLC's Richard Lashley, for example, only targets small banks and has launched over 50 campaigns at such institutions as Alliance Bancorp, Royal Financial, Metro Bancorp Inc. and several others.

Barington Capital's Jim Mitarotonda boasts expertise in a few sectors but a particular favorite is fashion. Before launching an activist fund, Mitarotonda worked at Bloomingdale's in New York. Later he took a job in the retail consumer banking group at Citibank before starting Barington in 1992. In the past the fund has concentrated partly on shoe businesses, with targets including Steve Madden Ltd., Stride Rite Corp., Payless ShoeSource Inc., Nautica Enterprises, Warnaco Group Inc. and others, many of which eventually were acquired.

Know when investors want you to settle. When faced with a proxy fight it makes sense to ask long-term shareholders whether they would like to see the company settle and add one or more dissident directors. At this stage it is essentially a must to hire a well-known proxy solicitation firm, such as Georgeson, Innisfree, MacKenzie Partners Inc. or Morrow & Co. Proxy solicitors are experts at making the company's case to shareholders in the face of a contest as well as providing corporate executives critical feedback from investors.

Cas Sydorowitz, CEO of proxy solicitor Georgeson Inc.'s European office, notes that proxy solicitors can give corporate executives and directors a good sense of whether their investor base believes a settlement with the activist is a good idea. If an overwhelming majority of investors back the activist then it may make sense to settle. However, in many cases, the outcome isn't obvious and a proxy solicitor's feedback could be useful.

It may make sense for a company to hire a proxy solicitor long before an activist shows up. A solicitor, Sydorowitz notes, can advise companies on key shareholder votes taking place at the annual meeting, including sometimes controversial non-binding votes on executive compensation plans as well as other potentially contentious precatory proposals. The goal is to help boards understand their shareholders and what they are likely to do in response to different corporate actions.

"They [companies] want to hire us to avoid any surprises," Sydorowitz says. "We interpret what shareholders have done in the past to best counsel companies on what they are expected to do in a future scenario."

Sydorowitz adds that some of Georgeson's clients will hire the company as an adviser when an activist has bought a stake but has yet to make any public noise. "In addition to talking to shareholders we provide an analysis of how have institutional investors voted in the past at annual meetings," Sydorowitz says. "Which shareholders have voted against company directors in the past? How have the proxy advisory firms recommended in the past?"

Keep in mind that activists also hire proxy solicitors at various stages of their investment cycle. In the most common scenario, activists will hire a solicitor to make a case to shareholders after launching a campaign. They also will retain proxy solicitors well before any insurgency has been initiated.

"We have some activist clients who hire us on retainer to look into various things such as a company's governance policy or how a particular investor has voted at a company's annual meeting," Sydorowitz said.

Bankers specializing in defending companies from activists should also be retained to talk to investors. In some cases institutional investors would prefer that companies fight and are disappointed when settlements put dissident directors on their boards.

"Part of my role is to talk to a lot of institutional investors, and we're starting to hear a little more pushback on these sort of quick settlements, and I do think you're going to start to hear that more," says Morgan Stanley's David Rosewater.

POSITIVE INACTIVITY: David Rosewater, chief of Morgan Stanley's shareholder activism team, says corporate executives must do a better job explaining to investors why they don't do certain things.

Defense practitioners in the U.S. like to point out that in the U.K., the environment is quite different, with investors for the most part saying that they don't want activists on corporate boards. "The [U.K.] stockholders have traditionally said 'Hey, I don't want you to put those people on the board because why not me?'" Rosewater explains.

Get a stock watch or register analysis service to identify your shareholder base. Knowing that an activist is accumulating shares privately before public disclosure is a key advantage — corporate executives in these situations can begin reaching out to institutional investors even before the activist has a chance to make its case.

To get this advantage and make sure executives have a handle on who their shareholders are, companies in the U.K. will hire a proxy solicitor or other consulting firm to conduct a so-called register analysis to fully identify their investor base. In the U.S. many beneficial shareholders of a corporation are hidden behind the banks and brokers executing their trades. So companies will hire a stock watch service to uncover those investors. Sydorowitz notes that both Nasdaq and Q4 Inc. offer stock watch services.

"Finding all the shareowners in the U.S. is very much an art as opposed to science so a stock watch service is important," Sydorowitz says. "The U.K. is a disclosure market so with the help of a register analysis firm companies should be able to obtain transparency for over 90% to 95% of their share capital."

Determine whether investors seek a break-up. If an activist is pushing for a break-up or a major stock buyback it is important to figure out if the rest of the shareholder base is of the same mind. If so, and the C-Suite team believes a break up doesn't make sense, it is important to go on the offensive and explain that rationale to as many investors as possible. "One of the things that companies don't do very well is explain why they are not doing the things they don't do," Rosewater notes. "Now there are certain things you can't explain, right? If you've got an asset in your company that you think should be sold to somebody else and you ran an auction and it busted, you're not going to go out and talk about that. But there's a lot of circumstances under which you can talk about, such as 'why we don't split off this business, why do we approach a certain aspect of our business in a certain way rather than in a way that an activist might look at it, why we do keep the cash that we keep.'"

If a business doesn't do a good job of communicating its strategy to shareholders the company will face criticism from investors who may believe other factors are at play. "When companies don't explain why they aren't doing something that looks like it makes sense, you are leaving the shareholders with no choice but to assume that it's because you're protecting your job, your pay, your empire, whatever it might be, and that those motives are improper or at least not focused on the shareholder where they should be," Rosewater says.

However, if activist shareholders are pushing for a break-up, other shareholders agree that it is a good idea and the company comes to see that there is a rationale for it then executives should take steps to make it happen. Trian's Peltz recalls that Trian had been seeking divestitures at Ingersoll-Rand Inc., a diversified industrial company that ultimately agreed to spin off its commercial and home security operations division into a newly public company called Allegion PLC during the fund's involvement.

"We came onto the board advocating that the company break itself up into three pieces, and they convinced us that they couldn't do three; that they didn't have the bandwidth at Ingersoll to do three. And we agreed that two was OK, and it wound up to be just fine," Peltz says. "Shareholders subsequenty benefited -- the stock price, margins and earnings at each company went up following the separation."

Allegion's share price is up about 58% since the split and trades at roughly $68 a share; the parent, Ingersoll-Rand, saw its stock increase to $62 a share.

"My experience with large U.S. public companies is they're very thoughtful about the divestitures they make," says Wittmer. "They ask whether this asset is going to be better off in somebody else's hands, or if I spin this out is the market going to value this better because they can't see the growth trajectory inside my much larger company."

Expect a rapidly transformed shareholder base. A major lesson for corporate boards and executives to consider as they anticipate the possibility of an activist campaign is that a big part of a company's investor base can transform almost overnight with friendly shareholders converted into a group of insurgents and arbitrageurs in the blink of an eye. As TheStreet's Jim Cramer puts it: "You could communicate a strategy to those people and they don't care."

A rapidly changing investor base is particularly likely if a name-brand insurgent such as Carl Icahn is at the gate. As a result, companies have to be careful and consider that a shareholder who supported the company's agenda might have cashed out — replaced by an arbitrageur investor who doesn't.

Consider the situation in 2014 when Allergan agreed to sell itself to Actavis plc in a move that thwarted an unusual hostile offer launched earlier that year by Valeant Pharmaceuticals and its activist partner, Pershing Square's Bill Ackman. Ackman argued that Allergan had a bad capital allocation program, a poor acquisition track record and too much research and development spending.

As the hostile bid and campaign ground on, a huge segment of Allergan's investor base changed dramatically. Long-term investors were replaced by arbitrageurs, hedge funds and activist firms pushing for a deal. The long-term investors sold out as the price of the stock rose to meet the premium offered by Valeant.

After Actavis acquired Allergan, its CEO, Brent Saunders, was installed as chief executive of the combined company. Looking back at the situation, Saunders explains that Allergan's then-CEO, David Pyott, faced a hugely transformed investor base. "All those great shareholders Pyott had cultivated and had spent a lot of time thinking about took the money and ran," Saunders said. "Most of the longs had left and the hedge fund and arbitrageur community had completely taken over the stock and they wanted the deal.

CHAPTER 4 Know Your Shareholder Base

They wanted the premium and so he knew he was on the ropes." Actavis became the white knight — a friendly acquirer — and increased R&D by 60% following the thwarted hostile bid by Valeant.

Consider also the case of Starwood Hotels and Resorts Worldwide Inc. Frits van Paasschen, who until recently served as CEO of the lodging company, suggests that shareholders often try to bully executives into making investment decisions that may not be beneficial over the long term. Van Paasschen recalls that what investors wanted from Starwood before the 2008 financial crisis was very different than what they have been seeking in the aftermath.

"Starwood like many companies in the run up to [the crisis] was under pressure [from investors] to lever up its balance sheet. Interest rates were low, and of course trees are going to grow to the sky and everything else," van Paasschen said. "The people [investors] that were clamoring for that were not around 18 months later when the stock was at nine dollars."

In some cases, a major shift in the shareholder base into one comprising activists and activist-type investors can be good. American International Group Inc. CEO Peter Hancock learned that in 2011, when the insurer was looking for buyers for the government's 92% stake in the business. The U.S. had acquired its controlling shares as part of its $182 billion bailout of the insurance giant during the financial crisis.

AIG Financial Products, which had operations in New York and London, sold billions in derivative products before to the crisis without having to hold sufficient capital to back it up. The division was considered a major contributor to the global meltdown.

However, by the end of 2012, roughly 35% of AIG's ownership base was made up of hedge funds. Hancock says he and then-CEO Bob Benmoshe split up into two teams and went on the road to meet with "hundreds of investors" to discuss what amounted to five equity offerings over an 18-month period. Hancock says the quality of discussions with shareholders varied but some funds were willing to invest $1 billion immediately, which suggests that they had done a serious amount of due diligence in the lead up to those meetings.

"Without activists and people willing to roll up their sleeves and understand the new AIG... we wouldn't be where we are today," notes Hancock. "We sold so many companies and it really required people willing to do their homework on us. So we owe a lot of the success of the turnaround to the engagement of activists."

Bring friendly shareholders aboard. Hudson Executive Capital's James Woolery, like most activists, supports the concept of directors owning more shares. Beyond having "skin in the game" he suggests, it makes sense for boards to bring on more large shareholders of all backgrounds. "Should we have directors who have more skin in the game? Sure. Why is that a bad thing? Should there be more shareholder representation on boards just de novo? Sure. Should boards go and get the fellow that just retired from T. Rowe Price or [California State Teachers' Retirement System] and bring that perspective in and have that perspective on the board? Of course."

Morgan Stanley's David Rosewater suggests that a friendly shareholder could ultimately protect a company from an activist: "If there's a shareholder who you believe is longer term or you believe is more willing to work with the board, not just in the sense of rubber stamping, but work with the board in terms of constructiveness, you know, having a different shareholder on the board can blunt the effectiveness of an attack from an activist."

As the battle unfolds, continue to talk to your long term shareholders. How does a company avoid an investor revolt? Wittmer contends that executives must regularly engage with shareholders. "Companies now are very, very proactive in talking with their shareholders, in particular the institutional investors and the long term investors in their stock," he said. "And it's a different kind of engagement than they have had before. They're out there telling them 'OK, here's our strategy, we'll explain it to you. Then what do you want to hear from us? What kind of key performance indicators do you want us to be reporting on as a long-term investment?'"

Such conversations, he says, could make all the difference when an activist starts asking other shareholders about whether they share their concerns. "I think they'll take the call [from an activist], but they will say, 'Yeah, I've already spoken to so-and-so at the company, and we understand their strategy,'" Wittmer says.

Expect pension funds unhappy with CEO pay to coalesce around an activist. That was the case in 2007 when Home Depot Chairman and CEO Robert Nardelli faced off against now-defunct activist fund Relational Investors Ralph Whitworth. Whitworth is considered the godfather of governance-focused activist investing. His campaign, which led to Nardelli's ouster, focused on what the dissident investor saw as a misaligned pay package for Nardelli that was coupled with the home improvement supply company's unremarkable stock performance during his tenure.

Home Depot eventually did bring on a dissident director — Relational Investors' then-principal, David Batchelder. Home Depot director Greg Dean Brenneman suggests that Batchelder's presence was positive. "He was there for four years. He was an absolutely terrific director," says Brenneman.

But Anne Sheehan, director of Corporate Governance at CalSTRS, argues that Nardelli's ouster had everything to do with shareholders taking issue with the company's executive pay plan. "At Home Depot, when you look at one of the reasons why Ralph and David at Relational Investors went in is that you had an upside-down compensation structure," she said. "The CEO was doing what he was incented to and it was the wrong metrics to use for the long-term shareholders. Compensation gone bad is a terrible governance problem."

Know which institutional investors invest in activist funds. One way to tell whether an institutional investor is likely to support an activist is if they are already invested with the insurgent. Some large pension funds support activists by becoming limited partners. These investments don't necessarily mean the pension fund will automatically vote for a particular activist's director slate but it makes it more likely they will back at least some of their candidates.

Sheehan points out that CalSTRS is an investor in both Blue Harbour Group and Starboard Value, two activist funds with different methods. "We support activists who employ all types of approaches," Sheehan notes. "Most of them would prefer the quiet activism of engagement on the front end but it is only when engagement doesn't succeed and they find an undervalued company with an opportunity to effect change that some will go to a proxy contest."

Larry Fink, the CEO of the largest U.S. asset manager, BlackRock, has issued letters in recent years cultivating a perception that he opposes short-term activists. Nevertheless, the fund has supported activists in proxy contests to a surprising degree over the years. According to an annual review of votes by Houlihan Lokey in September 2015, BlackRock supported dissident directors in seven of 18 proxy fights, or 39% of the time between July 2014 and June 2015, down a bit from 47% and 45% respectively in the two previous reporting periods between 2012 and 2014.

Zach Oleksiuk, chief of BlackRock's corporate governance unit, acknowledges that the institutional investor does support insurgent managers at times. The mega-fund is an investor in Blue Harbour, for example. "We too have supported a wide range of activist approaches," Oleksiuk said. "When an activist identifies an undervalued company and brings what we believe to be a compelling solution set we'll be inclined to support that activist."

However, he qualifies his comments to suggest that the fund may be more inclined to support management in many situations. "Absent some egregious failure or other bad behavior in board and management, management-led change is more likely to lead to sustained outcomes and we can afford to be patient," Oleksiuk insists.

Understand that all activists aren't the same — some are collaborative and others are hostile. One revealing characteristic that separates most activist fund managers from their passive counterparts is a penchant for launching proxy battles. However, not all activist hedge funds attack boards. Some never nominate their own candidates and instead work behind the scenes to improve share prices.

Consider Blue Harbour's Clifton Robbins and Hudson Executive Capital's Woolery.

Before launching Blue Harbour, a collaborative behind-the-scenes activist, Robbins cut his teeth at two private equity firms, General Atlantic and Kohlberg Kravis Roberts & Co.

In 2004, he had an "ah-ha" moment and decided to form Blue Harbour. "I realized with private equity, the goal wasn't to buy the whole company but to buy the best company," Robbins says. "If I could avoid the 30% to 40% premium that you have to pay when you buy the whole company but instead buy a minority stake in a company where there was scope to unlock value that would be a pretty good formula. And while private equity will be a good business model it does suffer from the fact that you have to pay an enormous premium to get started. I decided to start a strategy that is a private equity approach to public markets."

According to FactSet, Blue Harbour has launched campaigns at ten companies since 2004, though the fund has engaged with others out of public view. For Blue Harbour to buy a large minority stake in a company a lot has to fall in place. The target must be trading at a large discount to what Robbins believes is its intrinsic value; the fund's team must have some ideas to improve margins and unlock value and — in stark contrast to the approach employed by more aggressive activist funds — the CEO and board must be liked. In fact, unlike well-known mainstream activist funds, Robbins says he will never launch a proxy contest to elect dissident directors.

More hostile activists who aren't afraid to nominate director candidates question how the strategy could ever work without the threat of replacing board members. Yet, Robbins says the approach succeeds for Blue Harbour because he focuses on CEOs and boards he believes support his suggestions.

"I have felt always that the management and board matters the most," Robbins says. "If you are invested behind a management team and board you think is smart and hardworking with integrity — they know how to protect your capital when things come up unexpectedly."

In a similar vein, Hudson Executive also engages in collaborative activism without threats. But instead of a private equity approach to the public markets, Woolery and Hudson have signed up 37 former and current CEOs, with specializations in a variety of sectors, as both advisers and executive partners. Hudson, launched in August 2015, looks for opportunities in the mid-cap space at companies with between $500 million and $15 billion in market capitalization. When making an investment, Hudson brings one of its CEOs, who represent 70% of Hudson's capital base, to meetings with top executives.

"When we come to meetings with CEOs — we bring CEOs in their space with us," Woolery said. "We look for investments where there is a dislocation of fundamental value and there are operational and strategic opportunities, which means some kind of M&A opportunity that we think we can proactively effect."

For example, Hudson Executive has a large stake in CIT Group and has launched a behind-the-scenes campaign at the financial institution seeking to have it consider strategic options. Some shareholders have been pushing CIT to make divestitures that would bring it below the $50 billion size threshold that would significantly reduce its regulatory burdens and costs.

Woolery notes that when Hudson Executives officials met with CIT Group CEO Ellen Alemany to discuss the financial institution's strategic outlook they brought Richard Kovacevich, a former chairman and CEO of Wells Fargo who also is a partner and investor in the fund. "That's a different sort of meeting when you have this kind of asset that you can deploy," Woolery said.

Since launching the fund, Woolery noted that it has received inbound requests from sixteen corporations seeking investments and advice. So far only one of those companies —not identified — has received an investment from Hudson Executive while another may receive one soon. "There is a demand. Companies want to partner with us," he maintains.

It's unclear whether the Blue Harbour and Hudson Capital collaborative, no-proxy-fight, approach will take off as an asset class. But Hudson's Woolery defends the strategy, suggesting that the markets are moving toward a post-proxy fight world. If so, expect other investors to follow.

Consider the connection between collaborative and hostile insurgents. The two types of funds may end up complementing each other. Hostile managers can provide an invisible boost to the private campaigns initiated by Blue Harbour or Hudson Executive.

"The fact that it [aggressive activism] exists is helpful to Blue Harbour," Robbins said. "We meet a management team and we'll bring our ideas and they understand that if they don't embrace them or come up with better ones that there could be more aggressive activists they have to deal with."

Those ideas often involve M&A or a push to deploy cash into stock buybacks or dividends. For example, Blue Harbour is encouraging Xilinx, a San Jose-based semiconductor company that is debt free and has $2 billion in net cash to conduct a stock buyback. And Blue Harbour convinced Babcock & Wilcox to spin off its fossil energy business, which became Babcock & Wilcox Enterprises Inc. The fund still owns 10% stakes in both entities, in part, says Robbins, because they could soon become acquisition targets.

Evaluate proxy access, majority voting and other governance improvements. Some institutional investors are index funds and long-term pension funds that will always be invested in a large cross-section of the market. These investors have their own demands and companies should consider them carefully. In addition to concerns with over-tenured directors and CEO pay plans, many large institutional investors also want to see companies make other governance "improvements." Some of these changes could help when things heat up and management is looking to convince an index fund to stick with its incumbent board and reject an activist fund's candidates.

A new governance factor affecting corporate boards and their relationship with activists and institutional investors involves a controversial mechanism pension funds have been pushing for in recent years called "proxy access." The provision, if set up at a target company, allows long-term investors to nominate one or two of their own director candidates using a company's proxy card. As of early June, there were 240 Russell 3000 companies with proxy access mechanisms in place. That number is up significantly from the 134 companies that had the provision in place at the end of 2015, according to ISS Corporate Solutions.

Number of companies that have adopted proxy access in 2016*

S&P 500
181 37%

Other Russell 3000 Companies
240 8%

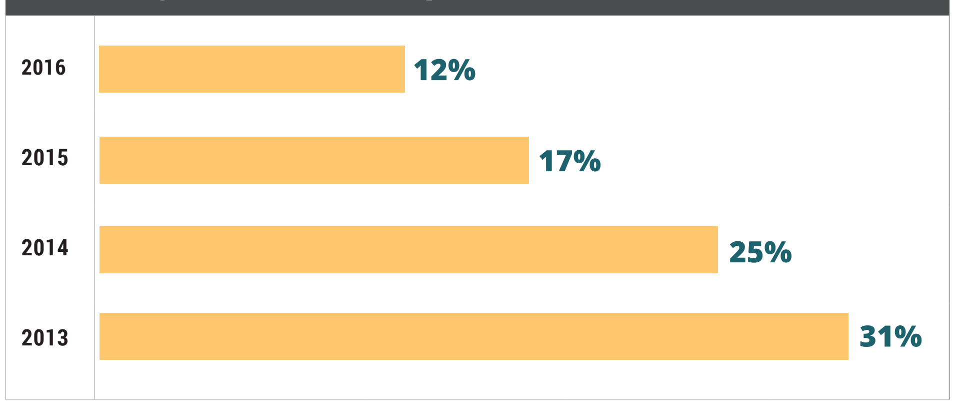
*2016 statistics through May 30
Source: ISS Corporate Solutions

The vast majority of corporations that have set up access regimes require groups of shareholders with up to 20 members to hold a 3% stake for three years before they can nominate up to 20% or 25% of the board on the company's proxy card. One major caveat: The measure hasn't yet been used by shareholders and it is only expected to be employed at companies with the most egregious performance and governance failures.

"We generally support proxy access as an accountability mechanism; not as a means to micromanage the composition of the board," says BlackRock's Oleksiuk. "Most boards are doing a good job of succession planning. Some are being spurred along by traditional managers and activist managers."

Like many other institutional investors, Sheehan notes that CalSTRS also supports proxy access. In addition, the fund has issued a large package of governance principles, including a recommendation that corporations hold annual elections and do away with the anti-takeover classified board structure that only allows a minority slate of directors to be elected each year.

Percentage of S&P 500 companies with classified boards



Source: ISS Corporate Solutions

CalSTRS — and other institutional investors — are also pushing companies into so-called majority voting regimes, a shift that would replace legacy plurality voting systems. With plurality voting — considered poor governance — even a single "for" vote for a director nominee can result in that candidate winning the election and the director essentially doesn't lose even if a majority are opposed.

Alternatively, companies with majority voting regimes give shareholders the authority to vote "for" or "against" incumbent director candidates. Unelected directors must at least submit resignation letters to the nomination committee or the full board. "We think that when a director has over 50% [against] vote they shouldn't stay on the board," Sheehan said.

Another key governance issue facing companies is whether they should separate the role of chairman and CEO. Many institutional investors are launching their own campaigns pushing for separation at a number of large and small companies. However, as of yet there is no consensus among institutions around the issue.

Director election standard*

Majority vote standard, director resignation policy, plurality carve-out for contested elections

79%	S&P 500
26%	Other Russell 3000 companies

*2016 statistics through June 10
Source: ISS Corporate Solutions

In the wake of the 2009 financial crisis, a vocal minority of public pension funds and other investors have launched a series of campaigns seeking to separate the roles of chairman and CEO at the largest U.S. banks. At Goldman Sachs & Co. in May 2016 roughly 30% of the company's voting shares opposed continuing to let Lloyd Blankfein retain both positions — not enough to convince the investment bank to split the role but a substantial enough number to raise serious questions about shareholder relations.

Number of companies with separate CEOs and chairmen*

S&P 500	249	51%
Other Russell 3000 Companies	1560	65%

*2016 statistics through June 10
Source: ISS Corporate Solutions

Sheehan says CalSTRS prefers that companies separate the chairman and CEO positions "because we feel they are fundamentally different roles and their responsibilities are different." Nevertheless, Sheehan notes that it is not an issue CalSTRS often goes public with. The pension fund did join the California Public Employees' Retirement System, or CalPERS, in a much-publicized campaign in 2015 taking issue with Bank of America Corp.'s controversial move to recombine the role of chairman and CEO after shareholders voted to separate it. Roughly 37% of shares voted against CEO Brian Moynihan holding both positions — not enough to oust him as chairman.

Bank of America's board recombined the roles in 2014, reversing a binding 2009 shareholder vote to separate the two positions that came after shareholders expressed outrage over former CEO Ken Lewis' role in the bank's acquisition of Merrill Lynch amid the financial crisis. Sheehan notes that a key reason that she and other funds specifically raised concerns at Bank of America was the unilateral nature of the bank's action. "The issue at Bank of America [last year] was that shareholders had voted to separate the position," Sheehan explains.

Recruit a strong lead director when CEO and chairman roles are combined. When the roles are not separated institutional investors say they like to see a strong independent lead director. CalSTRS' Sheehan will make suggestions to companies about ways they can strengthen the responsibilities of the lead director. "In the absence of a separate Chair, CEO, a very strong, empowered lead director is very important to us," Sheehan says. "When you get into a situation where the role of the chair has to be involved separately from the CEO, you need someone who really can step in and run that situation in those very unique, small set of circumstances and not mix the two positions."

Sheehan and Hudson's Woolery both support Jamie Dimon holding the roles of chairman and CEO at JPMorgan Chase & Co. Sheehan suggests that splitting the roles there may not be necessary because the bank has a "strong" lead director in Lee Raymond, a former CEO of ExxonMobil. "Raymond does a fantastic job as lead director," Sheehan says. "In the abstract I prefer separation but I also trust him as a strong lead director and he's not going to let someone like Jamie influence him when he thinks something is better for the board."

Some corporate executives and directors have reservations about the issue. Robert Hugin, executive chairman at Celgene Corp., says separating the roles can lead to confusion about the company's direction. Hugin previously served as Celgene's chairman and CEO and his replacement as chief executive, Mark Alles, reported to him for 11 years.

"I think a company can only have one strategy, one vision," Hugin said. "I think the world is so competitive and challenging, you have to be so focused on where you're headed, and everybody's got to be aligned to achieve it. I think if you can have one vision, then it works out OK, but I think when you have any kind of competition or confusion around where the company's headed, it's a terrible, terrible sign."

Hugin's comments reveal a disconnect between the interests of corporate executives and that of some institutional investors. However, anything corporations can do to placate index funds and institutions on governance matters without interfering with long-term strategy will go a long way toward ensuring that institutional shareholders support management when an activist strikes.

And even if you think investors will support management it is still vital that executives and directors gather as much information as possible about an adversary who is pounding on the gate. Remember, a huge percentage of the company's shareholder base can quickly turn over in favor of an activist, especially when Carl Icahn is involved. And the long-term investors you have cultivated over years may have sold out leaving arbitrageurs in charge. That's also why knowing the company has the support of certain long-term index funds, which may be seeking proxy access for example, could be the difference between victory and defeat. ■

CHAPTER 5

Are Your Directors Clueless? How About Your CEO?

CHAPTER HIGHLIGHTS

- **Directors out of touch with corporate needs must be replaced**
- **Term-limits don't work**
- **Rank and file investors are more likely to support removing an incumbent director who is overboarded**
- **Board members must pound the pavement**
- **Strategy should be the first item on the agenda at corporate board meetings**
- **Drastic action may be necessary or the activist will win**
- **When a CEO has to go, internal replacement candidates should be preferred**

Activists often launch proxy contests against directors or executives they believe don't have the skills necessary to keep the corporation competitive amid rapid economic and technological changes. In these cases, it may make sense to bring in new management-backed directors to appease disgruntled shareholders. If that doesn't work, more drastic action may be necessary — such as replacing the CEO or accepting some dissident director candidates.

Directors out of touch with corporate needs must be replaced. One major point of contention between activists and boards involves the assertion that some or all of the corporation's directors are out of touch with the company's current needs and demands.

In some of these cases companies and boards need to make the difficult choice to replace directors. Having the appropriate skills to meet the corporation's changing demands, particularly as technology transforms the fundamental nature of the business and its competitors, is critical. Directors who aren't equipped to meet a company's challenges and seize its opportunities are sitting ducks.

Frits van Paasschen, author of the forthcoming book *The Disruptors' Feast*, who until recently served as CEO of Starwood Hotels and Resorts Worldwide Inc., argues that corporate boards worried about being targeted by activist investors must make sure they have directors who meet the company's present needs — not past ones.

As CEO of Starwood, Van Paasschen faced a hotel industry besieged by the growth of Airbnb and other companies setting up websites to help people find non-traditional lodging. He contends that many companies don't see the disruption until it's too late. "It's like the car that's speeding toward you that doesn't look like it's going very fast until it's right there, and then it either hits you or it goes zooming past you and you realize just how quickly things are moving," he says.

Facing disruption, Van Paasschen insisted that Starwood needed to create a digital content resource management platform to deliver personalized services to high-end travelers. "The challenge in doing that though is you go from real estate to branding to technology platform, and any board has to then look at its composition and ask itself, do we have people on the board that really understand what's going on in this minute?" he asked.

Facing a similar technological revolution, The Home Depot Inc. director Gregory Brenneman contends that the issue of cybersecurity has become a bigger issue in recent years for the home improvement company and its board as has competition from the Internet, especially Amazon.com.

"Other players are entering the market so you have to make sure your board is evergreen and has a great culture of accepting new members and retiring out members whose expertise at one period was valuable but isn't so much anymore," Brenneman notes.

Activist investors at Delaware corporations can choose which incumbent board members they want to challenge. So a board with a vulnerable director or two up for election at a poorly performing company is more likely to be targeted. "Board members are on a board because they have a specific skill set to help the company succeed and sometimes things change," says Starboard Value's Peter Feld. "Just because someone was a good participatory board member ten years ago doesn't mean their skills are a good fit for today."

Feld compares the situation to fielding a baseball team. "You're not going to have nine first basemen," he said. "You need to have catchers, pitchers and outfielders — people with a variety of skill sets. For us it's about making sure we have trust and faith in people overseeing our investment in a company and that they have good independent thinking and that they're able to make good decisions on behalf of shareholders."

KEEP UP WITH THE TIMES: Frits van Paasschen, author of the forthcoming book *The Disruptors' Feast*, explains how corporate boards worried about being targeted by activist investors must make sure corporate directors meet present needs — not past ones.

Director term-limits won't help So what do you do about stale directors? One solution popular in some corners of the governance community is term-limits for board members. A limit of eight years, for example, would assure that new blood brings in new experience. However, many experts and activists reject the concept of a hard and fast term-limit. Instead, they say, a variety of factors should be considered to determine whether a director should be removed.

"We don't want to retire a director every eight years but we do believe that the average tenure of the board if you added all the board members up, should be a number that's not 20, 30 years or something extraordinarily high," said Home Depot's Brenneman.

Starboard Value's Feld agreed that a one-size-fits-all approach to board succession doesn't work. "If it isn't broken don't fix it," Feld said. "So if things are going well and the company is performing, certainly succession planning is important, but making change for changes sake is idiotic."

Rank and file investors are more likely to support removing an incumbent director who is overboarded. Insurgent fund managers like to criticize directors who are "overboarded" because they have taken on too many directorships at different companies and aren't able to devote enough energy to any one of them.

Companies may want to replace specific directors that are considered overboarded — or close to being overboarded — by the main proxy advisory firms.

For example, Institutional Shareholder Services, the leading proxy advisory firm, issued a policy update late last year to note that it would recommend that investors vote against incumbent directors who sit on more than five public company boards.

By that measure, there are a lot of overboarded directors. Steven Walker, general counsel at the National Association of Corporate Directors in Washington, cited a survey of members revealing that the average director sits on 4.7 boards, including public, non-profit and private directorships. In addition, he added that the typical director is spending 280 hours a year "in good times" serving on a board.

"That's a lot of time they are spending and if they are involved in a proxy battle or M&A transaction just multiply that number," Walker said. "Board service is becoming much more demanding."

And according to relationship mapping provider BoardEx, a service of The Deal, there were 76 individuals at U.S. companies that had seats on five or more public companies including publicly-traded investment funds. In addition, there were 247 corporate directors who sat on four boards.

The issue of overboarded directors can become a serious problem if the company they are overseeing is embroiled in financial difficulty. Case in point: The plunge in Valeant Pharmaceuticals International Inc.'s stock price in recent months after the embattled drug company warned that it might default on some debt. The plunge shined a spotlight on Valeant's board, especially Robert Alexander Ingram, who is a director and for a brief period served as the company's chairman. According to data compiled by BoardEx, Ingram, sits on four public company boards, including one based in Ireland, as well as three private company boards. In addition, he's a general partner at Hatteras Venture Partners and a senior adviser at GHO Capital Partners LLP. Given all its troubles, Valeant arguably deserved Ingram's undivided attention.

Directors need to pound the pavement and meet senior executives frequently. To help directors at Home Depot stay on top of strategy, Brenneman notes that the big-box home improvement and construction product company's directors get to know senior executives by spending lots of time together with them in the stores. "We began having each of the directors in 20 stores a year to get a feel for the business," Brenneman said. "There is a period of education that we believe is critical."

Strategy should be the first item on the agenda at corporate board meetings. As he envisions the boardroom of the future, Starboard Value's Peter Feld suggests that corporations should change the structure of board meetings to make sure that key discussions about strategy take place when everyone is present. "Take the committee meetings, try to do mundane things that need to be done the day before," he said. "Start at 8 a.m. the next morning to talk about strategy and execution so you spend enough time on important things."

Others agree that not enough boardroom time is spent discussing strategy. According to a 2015 corporate director survey conducted by PwC, roughly two-thirds of directors want at least "some" additional boardroom time to focus on strategy while one-in-five want much more time and focus on the topic.

"Boards will have strategy days for two or three days and conduct a few customer visits but you really should be thinking about strategy over time and and it needs to be grounded in a thorough understanding of our business, the industry and market trends so you don't get left behind," suggests Leslie Moeller of Strategy&. "Strategy shouldn't change every week and probably shouldn't change every two years but at some point the board should have a real discussion about strategy and renew it when in makes sense."

In some cases drastic action is necessary or an activist will do it for you. Feld argues that the board needs to focus on replacing the CEO if the company isn't performing for shareholders. "We're talking about the worst performers that have under-performed their peers for years not quarters," Feld notes. "The CEO runs the company and making sure that you've got the right person in that seat is critical, and it takes a good, active board to be able to make difficult decisions when the performance isn't good."

CEOs beware — activists bill themselves as change agents who can nudge boards in the direction of ousting long-serving, underperforming chief executives when directors are reluctant to do so on their own. They are especially likely to push for a move when the reluctance comes from directors who have known the top executive and each other for a long time.

When a CEO has to go, internal replacement candidates should be preferred. When looking for a new CEO it may make more sense to cultivate an internal candidate rather than seek out someone from outside the organization. Moeller, of Strategy&, notes that based on a PwC study, about 22% of CEOs have been brought in from outside over the last three years, up significantly from the previous decade. And he points out that most of those transitions were planned and did not involve M&A, with 55% of them being well-performing companies.

However, Home Depot's Brenneman suggests that internal candidates are best. He asserts that if a company doesn't have a well-qualified internal successor then of course outside candidates should be considered, but with the knowledge that a company's "risk-profile" will go up once an outsider is installed.

"If you go and you actually look at the success of those CEOs coming from the outside, it's a total crap shoot," Brenneman said. "You have much higher success, and studies prove this out time and time again, if you actually build the talent inside and have a great set of selections of CEO candidates on the inside, you are almost always going to be better off."

However, unlike most Fortune 500 companies, activists target troubled corporations with poorly performing shares. In these cases, notes Starboard's Feld, there often aren't good candidates on the inside. "When you have a weak CEO their internal successor tends not to be prepared for the role," he said.

Before the CEO becomes a problem, companies should be laser-focused on replacing overboarded directors and those board members who are out of touch with the corporation's strategy and changing needs. These changes are especially vital at the kinds of poorly performing companies that activists tend to zero in on. Insurgents are ready and willing to pounce on directors at companies where they can argue effectively, for example, that a board doesn't have the relevant mix of skills needed to ensure the business is able to compete with new rivals emerging around the corner. And while term limits don't work, corporate executives should have a good idea of when directors have become over-tenured and no longer possess the necessary skill-set to take companies to the next level. ■

CHAPTER 6

Activists Make News – Deal With It. Here's How

CHAPTER HIGHLIGHTS

- **Accept that activists are relentless and better at dealing with the press**
- **Find a good PR firm or proxy**
- **Acknowledge that insurgents get credit — however undeserved — for share price improvement**
- **Consider that journalists are talking to other investors**
- **Remember that small stakes won't necessarily discourage press coverage**

When an activist hedge fund of the Carl Icahn, Dan Loeb or Jeff Smith variety launches an insurgency at a Fortune 500 company it is a news event. As CNBC's David Faber notes, news organizations won't ignore a major activist especially when the investor is well-known and has a track record of success.

"They represent an opportunity for somebody in my position to break a story or to make news," says Faber, co-host with Jim Cramer of CNBC's Squawk on The Street. "If and when you can tell somebody something they didn't know about what Nelson Peltz is planning on doing or what Dan Loeb is doing or Bill Ackman then you are going to do it."

The battle between activists and companies can be asymmetrical: When the insurgent is on the attack the company is, by definition, in a defensive posture. Consider that in some cases the activist investor will alert one or more top-tier news organizations that their campaign is about to be launched. Fund managers or their proxies at external public relations firms often let journalists know that embargoed copies of "poison pen" letters to boards will be arriving in their inbox.

By distributing fight letters, the activist seeks to gain as much coverage as possible for the campaign once it is officially public. The goal is to reach as many listeners, viewers and readers as possible and bring new shareholders into the fold.

Those follow-on investors can help drive the stock well north of where the activist accumulated its original stake— especially when a big name such as Icahn strikes. And many of the new investors will likely support the dissident's proxy contest as it develops.

"The media is the gasoline that gets thrown on [activist] letters," contends Joseph Frumkin, partner at Sullivan & Cromwell LLP. "You get the media serving as a microphone for a really inflammatory messages and they are not going to stop because that's the media's business and that feeds the beast."

Activists are relentless. In some cases, an activist will fail to convince a particular reporter to cover a campaign because the journalist may believe that the situation represents too much of an advertising and marketing opportunity for the insurgent. "I don't want to be in that position where I feel sort of like 'I'm just being used to get something out there that doesn't really have a chance of happening or is unrealistic or is not really being told to me in the way that it actually occurred,'" Faber explains.

But even in those cases, expect that the activist will find other reporters willing to follow up. "They just move on and they find somebody else who'll do the story," Faber says.

Activists are better at dealing with the press. Nevertheless, once the campaign goes public, the target must quickly fashion a response. That means executives can be caught scrambling to get their story straight, especially when dealing with colorful poison pen letters attacking CEOs.

Advisors will provide a variety of options for executives and boards depending on the identity and reputation of the insurgent. Some advisers recommend a massive public relations offensive including efforts to get top executives and directors in front of TV and print reporters. But in so doing, the company will be playing on the activist's home field, so it might be better to keep away from the media altogether, no matter how badly executives want to fire back.

Marc Trevino, a partner at Sullivan & Cromwell LLP, acknowledges that activists are much better than companies at dealing with the press and that corporate executives at targeted companies should stay away from the media altogether. "They [activists] are in the business of dealing with the press," Trevino said. "You may be in business of dealing with your specific industry but you are never going to win in that fight and it's always very tempting and frustrating but our advice is let that play out because you don't win."

DON'T BE A TOOL: David Faber of CNBC's "Squawk on The Street" discusses how activist funds represent an opportunity for journalists to break a story or make news. However, reporters may decide not to cover an insurgent's campaign if they believe the ideas are unrealistic.

Get a proxy to speak on your behalf. Alternatively, Trevino notes, corporate executives should find someone else they respect to speak on their behalf. "If you are going to engage, find a long-term stakeholder, a customer, a long-term investor, a former director or a founder to come to your defense and to the defense of your strategy," Trevino said. "Its authentic and the only way you don't sound defensive yourself."

Frumkin agrees, though he also suggests that once an insurgent shows up it may already be too late. "The time to communicate is before the activist shows up," he said. "If you already have an activist there you're half-dead."

To illustrate the dilemma companies face, Frumkin posits the case of Icahn and his strategy to occasionally launch or conclude insurgency campaigns at large capitalization companies with a 140-character tweet. The tweets themselves can signal a massive buying or selling frenzy.

"You have someone like Carl Icahn who at 2 a.m. in the morning will take 30 seconds to think about and write a tweet and that 30-second tweet will result in hundreds of thousands of hours of work for the company," Frumkin notes. "It's completely asymmetrical."

Another example of the tilted playing field involves the question of who gets credit for major strategic actions that boost the stock—the company or the activist. Once an activist is involved, as Jim Snyder, formerly of Family Dollar suggests, they always get the credit. And even if the company had been planning to take the same or similar actions before the activist's foray, the resulting price improvement is often reported in a way that boosts activists' reputations and fundraising.

"If and when management sometimes does something that they may have been planning, the activists of course will claim credit for it because with activism, so much of it is about public perception of the power of the activist, so much of it is about advertising almost, in a broader sense, marketing yourself," Faber points out.

Nevertheless, the more established activists are not as likely to launch a public campaign simply to gain notoriety. "The thing that does an even better job for activists at raising money is performance, and if their performance is good over a good period of time, they don't care whether [the company is] in the news, they care about what your performance is, that will attract assets," said Morgan Stanley's Rosewater. "Now it is true that the sort of histrionics we've seen at times can attract attention and make people think that you are somebody to be reckoned with and therefore someone to invest with, but I think that's thankfully less the rule than it used to be."

Generally speaking, companies are in a difficult position when they are targeted by activists and an external crisis management or public relations firm is essential if the investor is deemed a serious threat.

"They [activists] can be much more vocal about it than a U.S. public company," said Colin Wittmer, deals advisory partner at PwC. "I think there is the right time to use the press, in particular if they're talking to your customers, they're talking to your suppliers, it's absolutely going to fundamentally cause problems in your business, I think getting with a PR firm, using the press in a responsible way, is absolutely the right way to do it."

CNBC's Faber notes that public relation firms such as the Brunswick Group are well positioned to advise corporate boards and executives on how to handle the media before, during and after an activist strikes.

"They've [public relations firms] done a very good job of getting CEOs and managements and boards to think longer and harder about what will they do if somebody's coming," Faber says. "So they're thinking about how they would communicate, who they would communicate with and they're being proactive in terms of reaching out to some of the press who might follow them, although these days that becomes more difficult because there are so few who really do."

Faber contends that companies should put their executives in front of the media more frequently, so that news outlets can give both sides a chance to make their case. "They're saying this and the company's saying that, but at least you want to give everybody a fair hearing. At some point, you make a decision," he says.

Consider that journalists are talking to other investors. Corporate executives should be aware that journalists covering an insurgency also try to talk to creditors, directors and other investors who own stakes in the target. "As a reporter I go out and also try and talk to other shareholders also because those are the people who matter," Faber notes. "Particularly in a battle, hearing from people who I trust and have relationships with for a long time, who are kind of unaffiliated at least, helps me in terms of how I'm seeing things."

Small stakes won't necessarily discourage press coverage. The size of an activist's holdings may factor into how much press coverage the campaign will receive. A stake that appears small as a percentage of the company's total market capitalization still will be covered if it's made by a high-profile activist and especially if it is a large dollar amount. For example, Icahn's original 3.4% stake in American International Group Inc. was small as a percentage of AIG's market capitalization. But the fact that it was acquired by Icahn and was worth billions of dollars suggests that it is a serious campaign. The result was heavy coverage. The size of the position relative to the size of the activist's overall fund, also matters. For example, if it's the largest position in a big fund—that suggests the activist is serious about its campaign.

"If it's a good dollar amount it makes you one of the larger shareholders," Faber says. "It's a case-by-case situation based on the reputation of the activist, at least in my mind, the arguments that they're making, the size of the position, and its importance to their fund as well all matter."

Still, companies should be careful not to dismiss small activists with miniscule stakes. Investors with just a handful of shares can garner significant coverage simply because their arguments are easy to comprehend and make sense to other shareholders and reporters. SpringOwl Asset Management's Eric Jackson, for example, owns only tiny stakes in Yahoo! and Viacom yet his well-researched 99-page presentations on targeted companies have resonated with journalists and likely will continue to do so. Significant press coverage can often be embarrassing for companies so it makes sense for investor relations officials to take shareholders like Jackson seriously early on.

SpringOwl's presentations resonate with the media and other investors in part because they are typically full of original research not available anywhere else. Consider details about a Great Gatsby-themed holiday party hosted by Yahoo! that Jackson estimated cost $7 million. Even though the media company asserted that the actual cost was one-third that amount the research employed to cover the expensive party enraged shareholders and spawned a firestorm of coverage in December 2015 by major outlets including the New York Times, Fortune Magazine, Business Insider and the Daily Mail. The attention put significant pressure on Yahoo! and eventually led Starboard Value in January to launch proxy fight that was settled in a deal that put the fund's Jeff Smith and three other dissident directors on the internet company's board.

And well-written if nasty "poison pen" letters — even if they are criticized by some influential Delaware judges (see Chapter 2) — are typically extremely attractive to reporters, especially if they come from well-known activists. Letters issued by Dan Loeb personally attacking a variety of executives over the years starting in the 1990s, helped transform his fund, Third Point LLC, into a media darling.

"You think about Dan Loeb and how he helped to cement his position early on, and I tell my kids this, because regardless of how you're going to succeed in life, I'm always like, you've got to learn to write," Faber notes. "I mean those letters. They were good, and say what you want, but that got people's attention. And then obviously he did it in very colorful language, and I think sometimes he stepped over the line to a certain extent, he was willing to do that, but it certainly got a lot of people's attention."

Trian's 2015 proxy contest at DuPont — the largest of the year— is a good example of what can happen in an asymmetrical media environment. Trian's Nelson Peltz did a 27-minute interview on CNBC while Ellen Kullman, CEO of DuPont at the time, was nowhere to be found. "Peltz made you feel like he knew what he was talking about," explains TheStreet founder Jim Cramer. "Ellen Kullman, nothing."

Crawling into a hole, hoping the activist will disappear, isn't a good strategy. But companies should wait for the right moment to respond. "It's not about winning the media day," Rosewater says. "It's about making sure that you, as a company, prove out your strategy, and you know, it's about persuading your shareholders that you've got the right strategy, and that they should stay the course."

Frits van Paasschen, author of the forthcoming book *The Distruptors' Feast,* points out that corporate executives have the option of telling reporters the same details they provide to shareholders. "It's all the same story, right?" van Paasschen said.

For now, the media landscape will continue to heavily favor the media-savvy insurgent, leaving many questions for companies trying to figure out how best to respond. Preparation is key and external public relations and crisis management firms should at least be on call. And companies should have a few high-profile proxies ready to step in and present the company's message, particularly if the CEO is advised to stay out of the limelight and focus on the business. Of course the best public relations defense is to take actions to prevent an activist from showing up in the first place. ■

CHAPTER 7

Trian and the Art of Highly Engaged Investing

CHAPTER HIGHLIGHTS

- **Understand operational vs. financial activism**
- **Heed the lessons of Ellen Kullman and proxy battle settlements**
- **Cultivate institutional investor support**
- **Remember that Sarbanes-Oxley set up the most important governance protection**

One of the most respected investors in the U.S. is Trian Fund Management, co-founded by Nelson Peltz, Peter May and Ed Garden. Simply put, an investment by Trian can't be ignored. Formed in 2005, Trian has made over 25 investments, and participated in just two proxy contests.

And it doesn't matter that the number of companies in which Trian has invested isn't as large as that notched by certain high-profile activists. Trian has invested in some of the biggest brand names of the last decade. The objects of Trian's attention include Cadbury Schweppes, General Electric, Ingersoll-Rand, Kraft Foods, Bank of New York Mellon, H.J. Heinz, Wendy's and DuPont.

Understand operational vs. financial activism. What is so special about Trian? Its founders, Peltz, May and Garden are considered one of a rare breed of investors known as "operational activists" because they have a proven track record of running companies. "Financial activists," on the other hand, often come from hedge fund backgrounds and typically focus on balance sheet initiatives such as making capital distributions or increasing leverage.

Peltz and May are known for the acquisition and turnaround of Snapple Beverage Group in the late 1990s. That operational experience contributed heavily to Trian's partial victory in a campaign at Heinz in 2006, shortly after the firm's founding, where they succeeded in installing two of five director nominees, including Peltz, on the ketchup producer's 12-person board. In fact, shareholders acknowledged that success by voting in huge numbers to reelect Peltz and former Snapple Beverage chief Michael Weinstein, a Trian nominee, to Heinz's board.

The fund is well-known for taking time — sometimes a year or longer — to produce and disclose well-researched white papers prescribing changes at companies in which it invests. Its industry specialists meet regularly and discuss potential ideas, most of which are later discarded. The few investment ideas that aren't discarded are debated by a 17-person Trian team until they "can hold up to a public argument." White papers are written before Trian buys its first share of stock.

Trian doesn't like the activist moniker. As Larry Fink, Chairman and Chief Executive Officer of BlackRock, recently noted: Trian is a "highly engaged shareowner." In response, Peltz says. "We have taken that and we are going with that label. That's what we are. We are long-term and we're trying to make these companies better in the right way."

Trian acknowledges that it is sometimes appropriate to seek board seats at a target. That decision depends on whether Trian believes the company is taking steps in line with the firms's white paper. For example, Peltz says Trian doesn't expect to need to have director seats at General Electric, where Trian made a $2.5 billion investment last year. Trian issued an 80-page white paper mostly praising GE's recent operating and strategic initiatives. The investment, known in some circles as "validation capital" suggests that for now GE's performance is on track with Trian's expectations.

BE BRAVE: Trian Fund Management's Nelson Peltz tells the conference that it can be difficult for some CEOs to accept shareholder criticism about underperfomance, and it takes courage for them to recognize that some of the investor's ideas may be worth adopting.

And Trian contends that at DuPont, another major investment, the chemical giant "has come full circle" and is taking steps in line with Trian's recommendations. That wasn't the case last year.

Heed the lessons of Ellen Kullman and proxy battle settlements. The highest-profile proxy contest of 2015 took place between Trian and DuPont, and resulted in a narrow loss for Trian. But the results are deceiving. In fact, the contest offers some lessons about when companies should settle with activists and when they shouldn't. In the months following Trian's defeat, DuPont's stock price dropped and the chemical giant subsequently replaced its CEO, Ellen Kullman.

A settlement with Trian could have preserved Kullman's job. Says Peltz: "Had DuPont given us one seat on the board I would say that Ellen Kullman probably would still be CEO of DuPont. We did not call for her to step down."

Following the proxy contest, DuPont's lackluster performance, which Trian warned about likely contributed to Kullman's departure from DuPont. Her departure also set the stage for the chemical giant's blockbuster $130 billion merger with Dow Chemical Co. announced in December 2015. The deal, one of the largest combinations on record, will briefly create a super-sized chemical company until the plan to split into three separate businesses is carried out.

Trian had been a DuPont investor for almost two years before going public with its campaign. Trian did not meet with DuPont's full board until after Kullman was replaced. "Once Ed Breen took over, he blew the doors and the windows wide open, and we met with the entire board.," Peltz notes.

Peltz recalls that he and Trian co-founder Ed Garden presented several options for DuPont at the October 2015 meeting, including the idea of a merger with Dow followed by a three-way separation. Shortly afterward, when Breen shifted from interim to permanent chief executive, he asked Trian to sign a confidentiality agreement and urged Trian to help DuPont and Dow Chemical work on developing the multi-part transaction. "We signed confidentiality agreements and we worked very closely with both management teams to craft the transaction. The new companies are, in my view, going to be three must own companies," Peltz says.

Cultivate institutional investor support. Trian also contends that it learned some lessons from the DuPont loss — specifically that it was important for the firm to engage with index funds earlier in the campaign. Trian received 46% of the "for and against" vote. Had Trian received the backing of one of a few large index funds, Trian would have won the contest.

"We didn't handle the index funds properly. We should have explained our point of view earlier in the process," Peltz argues. "We spent a lot of time with the mutual funds and they overwhelmingly supported us; we are now spending more time with the index funds and I believe they better understand our strategy and I hope they view us as highly engaged long-term investors."

Remember that Sarbanes-Oxley set up the most important governance protection. Peltz contends that the Sarbanes-Oxley Act of 2002, written in the wake of the Enron and WorldCom scandals, set up a critically important governance policy: The requirement that boards hold non-executive meetings. Back then, the measure was not considered an important provision, and in many quarters, that is still the case. Nevertheless, Peltz contends that it is underrated.

Under the provision, the Securities and Exchange Commission (through rules put out by the stock exchanges) requires that non-management directors must hold regularly scheduled meetings without members of the executive team present.

"Every regularly scheduled board meeting should have an executive session. It's the one time that independent directors can and should talk among themselves about strategy, what's going right, what's going wrong And, it's a time to informally assess management's performance. It's invaluable" Peltz explains.

The Trian team is always researching new investment ideas, and when Trian invests in a company, expect the company's institutional investors to listen closely to what Trian has to say. Given Trian's deep operational background and long track record of engaging with boards and management teams, it is fair to say that Trian can be a catalyst for improving long-term performance, rather than an adversary. ■

CHAPTER 8

AIG, Icahn and a Lesson in Transparency

CHAPTER HIGHLIGHTS

- **Make your company more comparable to others**
- **Repeat as necessary: buybacks, buybacks, buybacks**
- **Watch out for next year, even when it appears an activist has been thwarted**
- **Sit down and talk to activists and other shareholders**
- **Pay attention to nomination deadlines**

One response to an activist seeking corporate break-up is to split the company from a reporting perspective, making it more easily understood by the markets. This course was part of the solution engineered by American International Group Inc. CEO Peter Hancock in response to a Carl Icahn campaign seeking to have the insurer separate into three public entities focused on life, property & casualty and mortgage insurance. Icahn's campaign was premised on the idea that the separation would unlock shareholder value while convincing regulators to drop the "Systemically Important Financial System" designation they had placed on the insurance giant. That label subjects AIG to a variety of yet-to-be-defined but likely tough capital and liquidity restrictions as well as bank-like stress tests and living wills.

Icahn succeeded in convincing Hancock in February to back a settlement that put a managing director from his firm and fund mogul John Paulson on a slightly expanded AIG board. The settlement was viewed by many in the activist arena as a partial victory for Hancock, largely because AIG for the most part, didn't accede to Icahn's breakup plan.

A key component of Hancock's victory stemmed from a shift in the way the company explained its complex business to shareholders. Hancock acknowledges that Icahn and Paulson's push drove him and AIG to become more transparent in its reporting. One specific move was to split AIG's reporting into two parts — an operating and a legacy segment.

"AIG was not as well understood as it could have been," Hancock said. "The involvement of the activists has prompted us to be more transparent in segment reporting and that makes it easier for all investors to understand where the earnings are coming from and what we're doing to improve the return on risk. Some activists are very adept at noticing when a company has sort of taken their eye off the ball or failed to explain themselves well and you know, I think we have to keep on holding ourselves to account."

Make your company more comparable to others. One of the goals of breaking out AIG's earnings into different components was to make it easier for investors, analysts and others to perform peer comparisons, which had previously been difficult if not impossible. Hancock contends that the new reporting system makes it easier to understand return on earnings and capital allocations for each modular business unit.

CHAPTER 8 AIG, Icahn and a Lesson in Transparency

"We're operating in 90 countries, in hundreds of products, and there are niche players that compete with us in some of those countries and some of those products with some of those customer segments," Hancock explains. "So breaking down our earnings into components and being able to explain where we make our money better was important."

Hancock argues that focusing on managing and explaining the business goes 90% of the way toward heading off an activist. "It's so easy to get dragged in to a battle over the things that don't matter and as a CEO, my job is always to deal with distractions from all sides," he says.

LET THE SUN SHINE IN: American International Group Inc. CEO Peter Hancock explains how he responded to Carl Icahn's campaign to break up the insurance giant by increasing its segment reporting transparency — and it worked.

More reporting transparency also made it easier for Hancock to persuade his numerous shareholders that Icahn's concerns about regulatory costs associated with its "systemically" important designation was not a major threat for the business. In addition, Hancock said AIG was able to convince investors that the insurer would face major tax and ratings consequences if it were broken up.

"The rating agencies give us tremendous credit for diversification, and our ability to shoulder the risks that an insurance company takes from all around the world is very much … based on diversification," Hancock said. "I think we were able to persuade everybody that there are other ways to simplify the company without losing those important attributes."

Repeat as necessary: buybacks, buybacks, buybacks. AIG took other steps, beyond transparency and communication, to fend off Icahn. Activists often pressure a target to use some of its cash for stock buybacks or dividends. Sometimes companies will expand their capital distribution authorizations when faced with an activist even if it is not requested. The goal of boosting buybacks and dividends is to mobilize support for the management team and board among shareholders. The tactic doesn't always work.

For example in 2013, Sotheby's then-CEO William Ruprecht suggested in comments released as part of a Delaware court case that the auction house would gain "enormous tactical" leverage with 85% of shareholders who are not activist if it returned "a couple hundred million" quickly to shareholders in advance of the public launch of a campaign by Third Point's Dan Loeb. The move, he said, would suggest that the company is a responsible steward of their investment. However, a subsequent capital distribution effort wasn't enough to fend of Loeb. In 2014, Sotheby's settled with Third Point to expand its board to 15 seats and add three dissidents in a move that was followed by Ruprecht's resignation.

At AIG, Hancock responded to Icahn in part by using distributions. In February, AIG authorized the repurchase of $5 billion in additional shares, a move that brought its buyback authorization up to $5.8 billion. The insurance giant repurchased about $11 billion in shares in 2015. In the first quarter of 2016, AIG repurchased $3.5 billion in shares and paid $363 million in shareholder dividends. Between the end of the first quarter and May 2, AIG bought back an additional $870 million in common shares. "We returned $12 billion to shareholders last year in buybacks and dividends. We plan to do another $25 billion over the next two years," Hancock says.

AIG also took a number of less obvious steps in response to the campaign. In addition to a breakup, Icahn wanted AIG to cut costs. "We're on the track to reduce our costs by $1.6 billion over the next two years to become more focused, and we've sold over 90 companies and we continue to sell companies that are noncore to our core franchise," Hancock said.

After a series of actions to cut costs, increase transparency and buy back shares, the two sides were able to reach a settlement involving two dissident director seats. A public fight, Hancock explains, would have been distracting. In addition, Hancock hopes providing Paulson and Icahn's director candidate with the behind-the-scenes information about AIG's internal financial information could help bring the two sides closer together.

"Anybody who has got good ideas is welcome and so giving somebody access to inside information hopefully, raises the quality of those ideas because they then see the tradeoffs in more clarity," Hancock says. "We're very optimistic."

Watch out for next year, even when it appears an activist has been thwarted. Despite Hancock's optimism, Icahn likely remains unsatisfied with AIG. For one thing, the insurer's stock price hasn't appreciated much since the settlement. For now the billionaire is likely in a listening and learning mode but it would not be unprecedented — or even unusual — for Icahn to come back with a follow-up campaign once his standstill agreement expires.

SHOW YOUR WORK: Peter Hancock, CEO of American International Group Inc. discusses how the mega-insurer responded to activist Carl Icahn by making its various units more comparable to rivals.

Other activists have returned after placing directors on a boards. Tom Sandell of Sandell Asset Management, for example, succeeded at installing a slate of four dissident directors on the board of Bob Evans Farms Inc. in a 2014 fight that went the distance. Even though the move led to the resignation of the restaurant chain's CEO, Sandell threatened to launch another contest the following year. Bob Evans staved off that battle by announcing a real estate monetization plan Sandell had previously requested. The plan was announced on the eve of a deadline to nominate dissident director candidates, suggesting that another contest was in the works.

For now, in addition to Icahn and Paulson, a number of other activists still hold significant stakes in AIG. Hancock notes that such investors make up roughly 12% of its shareholder base. Icahn's 4% stake represents roughly one-third of that after it was increased in the first three months of 2016 from about 3.4%.

Icahn's settlement prohibits him from nominating dissident directors until after Aug. 1, 2016, according to people familiar with the agreement. But it wouldn't prohibit Icahn from reviving his insurgency and nominating dissident directors at the company's 2017 annual meeting.

Hancock suggests that the first couple meetings with the new directors, Paulson and Icahn's nominee, Samuel Merksamer, a managing director at the billionaire's fund, have been productive with both sides having "found a lot of common ground around the core elements" of AIG's strategy.

But history suggests that this sort of comity could dissolve quickly, and lead Icahn to renew his call for a breakup.

CHAPTER 9

Conclusion – Time To Establish Your Plan

When a company has a cohesive strategy that can be explained effectively and an executive pay package that shareholders can get behind, activists are likely to remain at bay.

Corporate executives, directors and the investor relations community now should have a better sense of what practices can help companies stay off of an insurgent fund's radar. And when activists strike we've established a code of conduct for how to handle the situation.

First and foremost, to avoid an embarrassing and costly fight don't be a jerk. If you won't listen to us, then listen to a judge. Delaware Chancery Court's J. Travis Laster makes it clear that jerks don't do well. A constructive dialogue among directors, executives, activists and other shareholders can help ensure that a proxy contest never takes place.

Companies must hire an effective investor relations executive who can rally shareholders behind management's agenda. And governance improvements are critical — they can make investors and the influential proxy firms that advise them happier without making major changes to the structure of the business. Declassifying boards, separating the role of chairman and CEO and setting up "proxy access" to give rank-and-file investors some more influence are all essential governance policies that should be considered.

And when a fight appears inevitable, corporate executives and boards now have a list of factors they need to consider before deciding whether to dig in or settle. An activist's fund size, redemption rate, reputation, proxy fight track record and history of institutional investor support are all factors CEOs must evaluate before making a move.

Corporate executives can get a head start in figuring out what to do when an activist invests if they know a few details about their antagonist. Is it aggressive and likely to launch a contest like Starboard Value? Does it have an operational background like Trian? Or is the fund a collaborative agitator in the Blue Harbour mold?

And we've learned that it's best to poll your long-term investors before making any major moves all while keeping in mind that settling to add even one or two activists as directors could lead to a polarized board, the CEO's ouster and a dramatically different business agenda.

We now have a number of ideas about how corporations should tackle media and public relations when facing an insurgency, keeping in mind that when an activist strikes the playing field will be asymmetrical with initial reports likely to focus on the activist's point of view. And we understand the value of proxy solicitors and legal and banking advisers in the battle for the hearts and minds of your investor base.

When shareholders threaten to turn on you, a preemptive strike may be necessary. Propose a breakup.

But bear in mind that the poor performance at some post-split companies suggest that executives proceed carefully in this regard.

We know from Allergan's Brent Saunders that Carl Icahn can launch an activist campaign at a large specialty drug company without needing to know exactly what it does. A long slide in a share price coupled with an 87-year-old CEO with no shares and no succession plan are strong clues that a company needs help.

We learned that the board of the future should make corporate strategy the number one topic for discussion at meetings and that incumbent directors should have "skin-in-the-game" in the form of shares they accumulate over time to align themselves with other shareholders.

Counterintuitively, activists should consider that the same nasty "poison pen" letters that help them get the media attention could backfire if an insurgency ends up in the court of law. And an executive who follows Judge Laster's advice to avoid being a jerk will have an advantage in court as the adult in the room.

In addition, we learned that too many board members are overboarded, overtenured and unprepared for the extra work heaped upon them when activist hedge funds come a knocking. In addition, directors who no longer have the skills needed to oversee the company's changing needs may be the first ones targeted for removal.

Finally, experts from a variety of sectors have explained why directors and companies need to maintain open lines of communication with shareholders and either accommodate their requests or explain why a different course of action makes more sense. Otherwise, shareholders will believe that managers are only interested in enriching themselves at the expense of investors.

Some of the boardroom tactics discussed herein may help prevent an activist insurgency. And if not, they at least could be useful in keeping one from spinning out of control.

When a company has a cohesive strategy that can be explained effectively and an executive pay package that shareholders can get behind activists are likely to remain at bay. But activists are always hovering around. Surprisingly we have learned that many boards and companies simply do not have a plan set up in anticipation of an activist attack — a major oversight. So below are three checklists that can help companies establish a plan to: Keep off an activist's radar; defend the corporation when activists strike; and create shareholder value in the age of activism.

Executives and directors who tick these boxes will be ready to deal with activists and operate in this new age of corporate governance. ■

CHAPTER 10

Preparation for an Activist: A Checklist

So you think you are prepared if an activist comes knocking on your door?

Here are 19 things you should be doing NOW:

- ☐ **Craft a coherent strategy for the business and execute.**
- ☐ **Activists specialize in particular industries. Know who could target your company.**
- ☐ **Understand their track record of proxy fight successes and failures.**
- ☐ **Know which of your investors also invest directly with activist funds.**
- ☐ **Keep track of activist funds' size and level of investor support.**
- ☐ **Know who your institutional investors are and communicate with them regularly.**
- ☐ **Respond to long-term shareholder concerns about distributions, CEO payments, etc.**
- ☐ **Consider whether it makes sense to expand or launch a capital distribution plan.**
- ☐ **Hire IR executives and a corporate secretary who understand and can explain the company's strategy and governance effectively.**
- ☐ **Invest in a shareholder monitoring service and review 13F and 13D filings for any activists investing in your stock.**
- ☐ **Hire a law firm specializing in activist defense strategies to set up sophisticated bylaw amendments alerting company insiders of "wolf pack" investors, activist-director pay arrangements and any of their debt or derivatives holdings.**
- ☐ **Retain a crisis management/public relations firm.**
- ☐ **Interview potential activist defense bankers and be ready to retain them when activists strike.**
- ☐ **Work with law firms, banks and PR firms to prepare a plan of response.**
- ☐ **Identify well-respected proxies ready to make a case for the company.**
- ☐ **Improve governance, communicate with proxy advisors to boost scores.**
- ☐ **Evaluate proxy access, majority voting and other governance improvements and whether they could help with index fund concerns.**
- ☐ **Develop a CEO and board succession plan.**
- ☐ **Ensure directors acquire shares to align them with shareholder interests.**

CHAPTER 10 Preparation for an Activist: A Checklist

An activist has targeted your company and board. Don't panic.

Here are 17 things you should do:

- ☐ **If the investor isn't helpful and has no track-record, don't waste your time.**
- ☐ **If the activist poses a threat and/or has some good ideas, open a dialogue and set up face-to-face meetings.**
- ☐ **Develop trust between the activist and company.**
- ☐ **Try to provide a "window" into the company so the activist gets a clear picture of the business.**
- ☐ **Maintain a constructive dialogue throughout exchanges.**
- ☐ **Consider whether the activist has operational experience or is only a balance sheet insurgent.**
- ☐ **Treat the activist's suggestions seriously and hire outside advisers to help assess them.**
- ☐ **Bring on management-backed independent directors in an effort to refresh the board and appease disgruntled investors.**
- ☐ **Consider minority stake investments from collaborative activists or from a 'white squire' private equity firm and install their representatives on the board to help protect the business from hostile insurgents.**
- ☐ **Consider the size of the activist fund's stake as well as what percentage of the other shareholders are likely to support it.**
- ☐ **Know whether your shareholders want you to settle.**
- ☐ **Evaluate whether an expanded stock buyback program or new dividend could help appease your discontented shareholders.**
- ☐ **Consider whether some smaller strategic M&A moves could be enough.**
- ☐ **Examine any "golden leash" payments the activist might have set up for director candidates and publicize those arrangements.**
- ☐ **Determine whether a settlement to add one or two dissidents is preferable to many months of painful and costly proxy fights.**
- ☐ **Engage activist defense lawyers and bankers to help determine your next step at every stage of the campaign.**
- ☐ **If it comes to a contest, hire an established proxy solicitor to engage with your investor base.**

CHAPTER 10 Preparation for an Activist: A Checklist

Eight ways to be constructive and create shareholder value:

- ☐ **Craft a coherent business strategy and execute it.**
- ☐ **Explain it effectively to shareholders, creditors and employees.**
- ☐ **Analyze the Timken and Ingersoll-Rand break up examples to determine if splitting the business makes sense.**
- ☐ **If the company is undervalued and various units have no synergies channel your internal activist by breaking up the company to create value.**
- ☐ **Refresh your board — bring on new directors to meet the company's changing needs.**
- ☐ **Replace over-boarded and over-tenured directors.**
- ☐ **Begin cultivating a potential CEO candidate from within the organization.**
- ☐ **Ensure executive pay is aligned with share-price performance.**

CHAPTER 11

Activism and Governance Resources

Corporate executives worried they may soon face activists or those already in the crosshairs can consult a wide variety of resources. Most are easily accessible — you just have to know where to look. Here's a compilation of periodic reports and other assets that can help executives prepare.

1. Lazard's 13F filing analysis

Four times a year, about 45 days after the end of each quarter, investment funds with over $100 million in assets must report their positions in filings with the Securities and Exchange Commission. The reports, filed under the SEC's Form 13F, are usually the first place interested observers can find out if well-known activists have accumulated new positions in potential target companies. However, there are dozens of funds making allocations and it may be difficult to cross reference all their investment reports to determine whether an activist wolf pack is gathering around a particular company. Lazard's Corporate Preparedness Group's 13F filing analysis, issued quarterly, does that work. The firm has identified 33 activist investors and 33 additional notable investors who often support or launch campaigns with analysis broken down by sector and company. For example, according to Lazard's May report, activists Third Point and FrontFour accumulated new positions in Nomad Foods, where Corvex and Pershing Square already held large positions. Lazard also issues a periodic report with extensive profiles of shareholder activists. Its latest report issued in June profiled 55 activist funds, giving readers a glimpse into their strategy, holdings, assets, stakes and top managers.

2. Houlihan Lokey's Proxy Voting Review

A company faced with an activist campaign will quickly try to determine which of their largest investors are likely to support a dissident slate of directors. BlackRock, Vanguard and State Street Global Advisers — the largest U.S. money managers by assets under management — often rank among those major shareholders. Boutique investment bank Houlihan Lokey gathers and analyzes their vote information, which must be made public in SEC N-PX securities filings, and issues periodic reports on its findings. According to the bank's most recent annual review of votes, released in September 2015, State Street voted in 15 large proxy fights and supported only 10 dissident directors out of a possible 62 nominees. The review, which examined proxy fights between July 2014 and June 2015, suggests that State Street is more likely to back the company's slate. The report also provides highlights about specific contests, where the backing of one of these funds might have tipped an activist into the win column. Knowing whether your top institutional investors are more or less likely to support a dissident campaign will give corporate executives a leg up when an activist strikes.

3. FactSet SharkRepellent

FactSet issues activist-specific profiles, starting with brief explanations of the fund's history and a background about its key partners. The reports then recount the activist's history, with details about campaigns, proxy fights and letters to boards. Each proxy fight is broken down with information about the outcome, whether activist won, lost, settled or withdrew its candidates (withdrawals often happen when the the company is sold). Campaigns without proxy fights are also explained. A quick read through a FactSet report will leave any corporate executive significantly more prepared for what lies ahead when an activist strikes.

4. Activist Investing

An annual review of trends in shareholder activism. Activist Insight, a provider of news, activist profiles, campaign histories and other reports, together with activist-defense law firm Schulte Roth & Zabel LLP issues an annual review of trends in activism. The report typically includes a series of articles, interviews and studies about the strategy written by high-profile advisers. The most interesting section of the report every year is a ranking of the top ten insurgent funds based on a variety of criteria including the number of companies where public demands were made, average size of the targets and average annualized stock price performance. Topping the report's 2016 list was Paul Singer's Elliott Management, followed by Carl Icahn and Dan Loeb's Third Point LLC. Equally interesting is the identities of funds added to and removed from the top ten each year. In 2016, Jonathan Litt's real-estate focused Land & Buildings Management LLC fund joined the list while Barry Rosenstein's Jana Partners and Keith Meister's Corvex Management were knocked off. Looking for a global view? The report includes details about targets, results and a map of the world breaking down the number of activism campaigns by country.

5. **Activism Monthly**

Activist Insight also collaborates once a year with law firm Olshan Frome Wolosky LLP in a review of director contests, settlements and emerging trends. In June, shortly after the end of proxy season, Olshan's top lawyers, Steve Wolosky and Andy Freedman, reflect on the previous 12 months and offer expectations for the coming year. Olshan is the top U.S. law-firm when it comes to advising activist investors in their insurgency campaigns, so the report is authoritative. In 2016, Olshan has already advised activists involved in 50 campaigns resulting in 74 new directors seated, most of whom were activist nominees. In addition, the firm has been involved in 42 settlements, up from 30 over the same period last year. The next Olshan-Activist Insight report, expected in June, will examine "reluctavists" — a new trend of otherwise passive hedge fund managers stepping up into the activist game by emulating the proxy-fights and director-election campaigns of well-known insurgents. The report also takes a look at how companies are fighting back and recent moves taken by some funds, such as Paul Singer's Elliott Management, to morph their strategy into a private-equity investment approach.

6. **Wachtell Lipton Rosen & Katz Corporate Governance Memos**

Marty Lipton invented the anti-takeover poison pill mechanism so it's not surprising that the law firm that bears his name tops our list of legal advisers to targets. The firm is typically involved in dozens of high-profile campaigns annually and every U.S publicly traded corporation should make sure to get Wachtell Lipton's corporate governance memos and presentations, which are distributed throughout the year. (Ask Wachtell to get on their email list). These notes are vital for companies preparing defenses. Some memos respond to regulatory developments affecting the activist-company dynamic; for example one examines the Justice Department's lawsuit against ValueAct Capital, setting up a showdown between the activist fund and the government over the future of shareholder insurgencies. Another provides a brief profile of FBR & Co.'s victory against insurgent Voce Capital, including a number of lessons for corporate executives who might face a similar challenger. These memos are useful, but keep in mind that Wachtell's activist defense team provides much more specific analysis to their paying clients in preparation for potential activism or in handling live situations.

7. **PwC Governance Insights Center**

A great resource for directors and corporations seeking insight into the world of governance. It even has a specific site dedicated to activism for executives, including a video introduction, an interactive risk-assessment test for executives and several reports and podcasts put together by PwC governance experts. Take a look at the governance center's reports on how to prepare for activists, what to do with excess cash and the best way to engage shareholders. The risk-assessment test takes just a few minutes and it may show that you are more vulnerable than you thought.

8. **Georgeson's 2015 Proxy Season Review**

Companies worried about being targeted by activists must make sure their institutional investor base isn't restless. And for public corporations located in the U.K., France, Netherlands, Germany or Switzerland proxy solicitor Georgeson's proxy season review is a must-read. The report details trends in shareholder votes and proxy adviser recommendations, with specific sections devoted to each country. The U.K. section, for example, examines shareholder resolutions receiving the most negative votes, including measures focusing on executive compensation, issuing of shares and efforts to require corporations to call annual meetings on short notice. A poor performance on any of these provisions could put any company in an activist's sights.

9. **The John Weinberg Center for Corporate Governance**

Charles Elson, chief of the University of Delaware's Center for Corporate Governance, hosts a symposium on governance that each year attracts more high-profile panelists and attendees. Corporate executives or directors hoping to learn about the latest trends in activism can expect to hear from top fund managers, proxy advisers, directors, judges, high-profile public pension fund managers, proxy solicitors and academics specializing in the sector as well as well-known institutional investors. And that's just in the morning. In the afternoon sessions, academics defend their latest papers on activism in a forum that includes an official "discussant" who usually offers prickly criticism of the reports. Elson also hosts other annual conferences throughout the year focusing on particular governance issues, such as "The Audit committee of the Future," "Board Composition, Refreshment and Tenure" and "Delaware Law Issues." Executives wanting to stay on top of the latest in governance issues will find some or all of these events useful.

10. **Skadden Arps Slate Meagher & Flom**

Skadden tells embattled corporations targeted by activists when to keep fighting and when to settle. The New York-based law firm is another top player representing companies faced with activists in a whole range of high-profile contests — though it also provides activist preparedness advice for potential targets. In recent years, the firm has represented more than a hundred companies faced with proxy fights and activist shareholders and it issues a periodically updated report offering an overview of all the contested situations it has been involved in with brief synopses about what specific advice it provided. Its top activist-defense lawyers, including partner Richard Grossman, also occasionally issue reports about trends in shareholder activism. The firm has represented corporate clients against a wide variety of activists, including Carl Icahn, ValueAct's Jeff Ubben and Elliott Management's Paul Singer. If a settlement isn't an option, Skadden can quickly assemble a litigation team.

11. **Harvard Law School's Forum on Corporate Governance and Financial Regulation**

A blog founded by Lucian Bebchuk, director of Harvard Law School's program on corporate governance, and several other academics is another useful resource. Many governance experts describe it as the leading online forum for discourse in the areas of corporate governance and financial regulation. Executives worried that their companies' governance isn't up to snuff may want to subscribe to the forum's e-mail list or at least periodically read articles posted by academics, lawyers, consultants and others. Categories devoted to boards, corporate elections, executive compensation and shareholder activism may be a good place to start.

12. **13DMonitor**

When an activist fund accumulates a stake of more than 5% in a company it must file a so-called Schedule 13D with the Securities and Exchange Commission and provide some details of their concerns about the target. 13DMonitor is one of the best sources of qualitative research on shareholder activism. The firm, managed by founder Kenneth Squire, provides dozens of profiles of insurgent funds. It also aggregates stories on activism from a variety of sources and provides a daily emailed report with analysis on all material 13D filings from entities with market caps over $100 million.