Shareholder Activism Knows No Bounds

A discussion with SRZ's global Shareholder Activism Group

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US activist hedge fund managers are targeting the world's largest listed companies, such as Procter & Gamble (P&G), which has a market capitalisation in excess of $200 billion. Schulte Roth & Zabel's (SRZ) leading shareholder activism lawyers are advising those managers, including Trian Partners, Elliott Management, Greenlight Capital and JANA Partners. Among numerous campaigns in the past year, SRZ advised Trian Partners in its campaign at P&G, the largest company to ever be the subject of a proxy contest.

'We expect activists will continue going after large caps and mega caps', says SRZ partner Marc Weingarten, co-chair of the firm's global Shareholder Activism Group. 'Their fund sizes are now so large that in order to move the needle, they have to go after large- or mega-cap stocks. They cannot invest enough in small- and mid-cap stocks. Indeed, Elliott runs $34 billion, Trian Partners $13 billion, Pershing Square $12 billion, and JANA Partners $7 billion.

The size constraint is heightened by activists' tendency to run concentrated, high-conviction portfolios with hefty positions. For instance, Trian had around $3.5 billion, or near 25 percent of its assets, invested in P&G. It became the company's sixth largest shareholder with a 1.5-percent stake. The return to activists targeting large-caps was among the many current trends discussed at SRZ's 8th Annual Shareholder Activism Conference in October 2017. The event was held in New York.

If some campaigns have not (yet) obtained their stated objectives, some proxy votes have been so unbelievably close that Weingarten expects 'both activists, and companies, will be emboldened to fight harder'. For instance, in the P&G case, Nelson Peltz won 973 million votes, or 48.6 percent, against the 979 million, or 48.9 percent, won by the other candidate. Clearly, this could have easily gone the other way.

What differentiates large-cap campaigns

'It is hard to generalise, but large-caps will often put up a fight and reject activist proposals. Others settle and accommodate activists' proposals', says Weingarten. The Trian/P&G case was expensive, with Trian spending $30 million, and P&G reportedly spending $100 million, on the campaign. Litigation (where SRZ's activism group has scored unprecedented litigation victories in numerous campaigns, most recently at Immunomedics), is less common in large- and mega-cap cases however, for various reasons. 'Larger companies tend to have better advice', says SRZ partner Ele Klein, co-chair of the global Shareholder Activism Group and a member of the firm's Executive Committee. They do not usually provoke investor litigation by denying shareholder rights, for instance. 'Larger companies are less likely to engage in brinkmanship, whereas smaller ones can get desperate and litigate', observes Weingarten. Additionally, the playing field has been levelled in terms of resources for litigation. 'In the old days, companies often had deeper pockets than activists, which were much smaller then. Now, the activists may have larger war chests than the companies', posits Klein.

Large- and mega-cap campaigns can differ from small- and mid-cap campaigns in other respects. 'Activists are rarely trying to replace boards of giant companies. It is harder to attack their board makeup as, generally, they already have high-quality and well-qualified directors for the most part', explains Klein. 'Though Trian Partners sought to add Nelson Peltz to the board of P&G, his first act would have been to reinstate any other board member who got voted off', Klein goes on. Sometimes, campaigns have no board agenda at all. 'Greenlight's General Motors campaign was purely about capital structure to create a new kind of stock with more upside. It had nothing to do with director replacement', points out Klein. 'Other large-cap campaigns focus on operational issues, strategic direction or share buybacks', he adds.
Legal advice is rarely the largest expense. Instead, companies and activists are spending millions on reaching out to retail investors, who tend to make up a larger proportion of shareholder registers for larger companies. 'A relatively low proportion of retail investors vote their proxies, and they tend to pay less attention to proxy advisors. Websites, social media (LinkedIn, Twitter and Facebook), television appearances, video recordings, automated dial in messages, and pamphlets can all be used to influence retail investors. The strategy can be to saturate retail investors with information to increase the chances of getting to them'. There is speculation that retail investors helped tilt the balance for P&G, as institutional investors are thought to have mainly voted for Nelson Peltz.

Passive investors, in the form of index funds (owned by retail or institutional investors), can also be more important in large-cap cases. 'They may take into consideration the proxy advisors but they have their own, in-house, corporate governance advisory teams', says Klein. Elliott has argued that activists and index funds are natural allies.

Activists also make common cause with institutional investors, such as pension funds. The UKs' largest pension fund, USS, supported Elliott's efforts in relation to a Dutch firm. Activists build credibility by 'demonstrating deep knowledge of a company, deeper than that of incumbent directors', explains Weingarten. This may be a greater task for larger companies, but the large activist managers have significant resources. They employ industry specialist analysts and may use external experts and reach out to former executives at target companies.

'Many activists have industry consultants on advisory boards or on the payroll. Trian's advisory board included former Heinz executives, points out Weingarten. 'It is always useful to get the views of third-party experts, as the media will talk to them about issues – and the target company may turn to them for support', Klein added. Activists' investment theses are usually articulated in a published white paper providing in depth analysis of failings, what steps are need for improvement, and what the activists would do differently if they and/or their slate of directors were elected. Many months of due diligence are involved in preparing white papers. Trian's 93-page white paper proposed that P&G reorganise into three units, amongst other things.

Certain activists have become sector specialists through great experience in particular industries. For instance, 'One activist fund specialises in airlines and was able to bring in a whole suite of expertise, including former CEOs, in the United Airlines case', says Klein. 'Elliott has tremendous in-house expertise in technology', points out Weingarten. Other firms focus on the pharmaceuticals sector or banks.

Though SRZ sometimes advises activist short-sellers on issues around avoiding allegations of misrepresentation and share price manipulation, long positions in common equity are where most activists are invested, as common stock carries the most clout. Some activists end up owning equity through debt exchanges, particularly in oil and gas reorganisations recently. In these cases, SRZ's activist teams dovetail with their other specialist lawyers on the distressed debt side.

Regulatory update on possible activist legislation

SRZ naturally keeps a close eye on rule changes. The SEC recently proposed for consideration whether investors should vote in 'universal proxies', whereby they can mix and match candidates from companies' and activists' slates, splitting votes between the two sets of nominees, in contrast to 'unilateral proxies', whereby investors must vote for the full suite of companies' or activists' candidates. SRZ acts as counsel to the Council of Institutional Investors, which advocates universal proxies as a matter of shareholder rights, to empower shareholders and give them more flexibility. Other stakeholders have different views. 'Companies, who currently decide if universal proxies are used, tend to oppose them, as seen with ADP resisting Bill Ackman's proposals. And activists are more mixed', Klein observes. 'Few campaigns have been carried out by either side where universal proxies were used', he adds. Of course, the lack of clarity on universal proxy outcomes can result in a stalemate where neither companies, nor activists, can fully pursue their goals.

Separately, Klein reckons the Brokaw Act 'is unlikely to be passed in its current form'. Part of the proposal would have the filing window being shortened from 10 days to some shorter period. 'There is much pushback and many reasons why the window should not be shortened', explains Klein. He also is of the opinion that the Brokaw Act proposals around so-called 'wolfpacks' do not mark any advance on current disclosure rules around acting in concert, which are well enforced by the SEC. **THFJ**