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Responding to Investor Concerns Regarding Activist Settlements

On October 10, 2016, State Street Global Advisors (SSGA) issued a press release and published an article expressing wariness about rapid settlements with activists without the input of long-term shareholders, a view shared by other large institutional investors. To address this concern, SSGA CEO Ron O'Hanley requested that "corporate boards develop principles for engaging with activist investors to promote long-term value creation." Specifically, SSGA calls for companies to:

- Engage with long-term investors prior to entering into a settlement agreement with an activist
- Consider the benefits (in addition to the costs) of not rushing into a settlement and instead proceed down the initial path toward a proxy fight, which offers "long-term investors and other market participants an opportunity to provide their views"
- Include provisions in settlement agreements to help align activist nominees with long-term investors, such as longer duration standstills, post-settlement stock-holding requirements, minimum ownership thresholds and a prohibition on pledging company shares

In addition, SSGA is creating a probationary period for one year after the settlement in which it will scrutinize any "unplanned financial engineering . . . to better understand the reasoning behind the strategic change."

SSGA is not alone in voicing these concerns. Over the past two years, other large institutional investors have been pushing back against short-termism and the risk of activism including through letters from Larry Fink at BlackRock and Bill McNabb of Vanguard. Norges Bank, Norway's $872 billion sovereign wealth fund, also expressed concern that quick settlements with activists could jeopardize long-term strategy. These investors' public positions are further supported by the formation of groups like Focusing Capital on the Long Term, and the publication of Commonsense Corporate Governance Principles, which encourage long-term thinking and are skeptical of certain forms of shareholder activism.

The SSGA release and other investor pronouncements make it clear that institutional investors – both passively and actively managed – are demanding to be consulted when their portfolio companies undertake key strategic decisions. Companies must engage or risk the ire of their long-term investors.

The Prevalence of Activist Settlements

The increasing prevalence of settlements with activist investors has created concerns among many long-term institutional investors. Citing ISS and Lazard research, SSGA notes that "as of August 2016, 49 companies had conceded 104 board seats to activists, almost on par with the 106 seats conceded by 54 companies in all of 2015." Settlements continue to gain traction, with SSGA noting that less than 10% of board seats conceded in an activist campaign in 2015 and 2016 resulted from a proxy contest, versus 34% in 2014.

The timeframe to settlement is decreasing too. The average time it takes companies to reach a settlement with activists threatening a proxy contest is currently 56 days from the time of disclosure of the activist's position, down from 83 days in 2010, according to research firm Activist Insight. SSGA's release raises the flag explicitly that "settlements are being reached too quickly and without any input from other shareholders," with the net effect of 13% of new board seats conceded via settlement so far in 2016.

The quick rush to settlement means that a significant number of companies facing an activist threat have made strategic board changes with limited input from the investors affected most by the director appointment or change in strategy.

How Should Companies Respond?

In light of this new institutional investor engagement environment, in the context of potential settlement agreements with activists, we recommend that companies take the following steps:

- **Prior to the Arrival of an Activist, Develop a Proactive Engagement Program.** Now more than ever, companies must maintain a comprehensive shareholder engagement program with both portfolio managers and governance teams. The engagement should include a discussion of long-term strategy and how it relates to board composition, governance and compensation practices. SSGA and other institutional investors seek the ability to provide input into these matters, and companies should not wait until an activist arrives to begin these discussions.
- **If an Activist Arrives, Solicit Feedback from Your Top Investors.** SSGA and other institutional investors want to ensure that their viewpoints are being considered before any major strategic, financial or board decision is determined. Additional engagement with investors will reveal perspectives on key items of the activist agenda and will help identify positions of strength from which the company can engage with the activist. Investors will also provide companies with context for which of the activists' arguments resonate with them and in which cases they would not support change. A failure to engage, on the other hand, will leave institutional investors frustrated at their inability to have a say in one of the most critical decisions a portfolio company can make. This frustration may be expressed through votes on future director nominees, Say on Pay proposals, or in future contested situations, especially if the activist makes incremental demands in the coming years. Settlements will only "keep the peace" to the extent that new issues aren't created because the opinions of some investors are not solicited.
- **If Long-Term Investors Have Viewpoints that Differ from the Activist, Consider Delaying Settlement or Letting the First Stages of a Proxy Contest "Play Out".** SSGA notes that while proxy contests "are distracting and costly (and can pose reputational risks), [they] give long-term investors and other market participants an opportunity to provide their views." SSGA's concerns about settlements are in line with our observations of the viewpoints of governance teams at many other major institutional

investors – the teams that represent either influential or decisive votes in a proxy contest. Too often, companies view the nomination deadline as a "point of no return," which forces rapid settlement. Forcing the activist to put its slate and its strategy into the public market, with the company providing a measured response to the activist's agenda and an openness to a constructive resolution, may be the optimal way to engage in "vote discovery" with the broader investor base. Moreover, this path does not need to be costly, contentious, or distracting if it is approached in a constructive manner. The feedback generated in the market by gaining insight on both positions can provide leverage to obtain a settlement that narrows the gap between the activist position and that of long-term shareholders.

- **If Settlement with an Activist Has Occurred, Conduct Post-Settlement Engagement Outreach.** Pre-settlement engagement remains the exception rather than the norm. Companies that have already settled with an activist without input from the full range of institutional investors must conduct that engagement with their broader investor base to explain their decision and why it was in the best interests of shareholders. Moreover, even post-settlement, the company will benefit from gaining investor perspectives before making any significant strategic, financial or governance decision, especially if these decisions are viewed to be a deviation from the company's pre-settlement path.

About CamberView

CamberView Partners is the leading provider of independent, investor-led advice to public companies on how to successfully manage investor engagement, contested situations and complex and challenging corporate governance issues. We advise company executives and boards on a wide range of events including contested merger situations, hedge fund activism, director elections, compensation matters, difficult shareholder proposals and more. CamberView helps its clients succeed with their investors by providing insight into the investor's perspective, explaining how investors will respond to the company's proposals, and creating successful proactive strategies for investor engagement.

CamberView Team

Abe Friedman
415.906.6501
abe.friedman@camberview.com

Pete Michelsen
415.906.6517
peter.michelsen@camberview.com

Derek Zaba
415.660.3902
derek.zaba@camberview.com

Sharo Atmeh
212.235.2905
sharo.atmeh@camberview.com