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Winning a Proxy Fight—Lessons from the DuPont-Trian Vote

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Editor's Note: Andrew R. Brownstein, Steven A. Rosenblum, and David A. Katz are partners, and Sabastian V. Niles is counsel, in the Corporate Department at Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell, Lipton, Rosen & Katz client memorandum by Messrs. Brownstein, Rosenblum, Katz, and Niles. Related research from the Program on Corporate Governance includes The Long-Term Effects of Hedge Fund Activism by Lucian Bebchuk, Alon Brav, and Wei Jiang (discussed on the Forum here), The Myth that Insulating Boards Serves Long-Term Value by Lucian Bebchuk (discussed on the Forum here), The Law and Economics of Blockholder Disclosure by Lucian Bebchuk and Robert J. Jackson Jr. (discussed on the Forum here), and Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy by Lucian Bebchuk, Alon Brav, Robert J. Jackson Jr., and Wei Jiang.

DuPont's defeat of Trian Partners' proxy fight to replace four DuPont directors is an important reminder that well-managed corporations executing clearly articulated strategies can still prevail against an activist, even when the major proxy advisory services (ISS and Glass-Lewis) support the activist. As with AOL's success against Starboard Value, Agrium's against JANA Partners, Forest Laboratories' against Carl Icahn and other examples, DuPont's victory is a notable exception to the growing trend of activist victories.

Each proxy contest is unique. For many companies, the risks and potential harm from a public proxy contest may lead the company to consider a negotiated resolution, especially when faced with the likely support of the activist by the proxy advisory services. The issues, tactics, team and approaches to an activist challenge will vary depending on the company, the industry, the activist and the substantive business and governance issues at play, among other factors. For those companies that decide a negotiated resolution is not warranted, or is not achievable on acceptable terms, the ability to wage an effective campaign will depend on advance preparation, proactive action, good judgment and effective engagement (discussed on the Forum here). The fact that DuPont, a leading American company with a distinguished Board and management, a strong track record and a long history of world-class innovation won only by a close vote after a long fight in the face of contrary recommendations from the major proxy advisory services underscores the challenges faced by all companies dealing with activists in the current environment. Below are a few initial takeaways from the DuPont-Trian vote.

Substantive Business Change. DuPont's own value-creating initiatives proved to be a central pillar of its successful defense. Instead of letting Trian frame DuPont as defending the status quo, the company demonstrated active management of its business portfolio (such as through the spinoff of Chemours), accelerated its cost-cutting plans, articulated a disciplined approach to R&D investment, increased return of capital through dividends and share buybacks, and made other productivity and business enhancements. As CEO Ellen Kullman argued, "We have been

agents of change. We have restructured. …we've got momentum. We are transforming." While Trian sought to take credit for these steps, in reality the company's own board and management was able to show that DuPont moved decisively to execute business and strategic initiatives.

Board Refreshment and Director Involvement. DuPont effectively wielded board change as an offensive tactic, adding two new "super star" directors with relevant expertise (Edward Breen and James Gallogly) to its distinguished Board and transitioning two strong existing directors to important roles on the board of Chemours. In addition, the DuPont independent directors, alongside the CEO and senior management, tirelessly advocated personally for their vision of DuPont, why they had earned—and deserved—the trust and confidence of shareholders and why supporting Trian would result in the board losing valuable expertise on the Board. In large measure the vote can be viewed as an endorsement by the shareholders of CEO Ellen Kullman and the DuPont Board as more likely to successfully lead the company than Nelson Peltz and the Trian nominees.

Tying the Campaign to Broader Themes and Securing Influential Third-Party Support. As we have previously argued (and discussed on the Forum here and here), the excesses of shareholder activism contribute to short-termist pressures that undermine economic growth, real innovation and sustained employment, and hinder prudent reinvestment of corporate profits into research and development and other value-creating initiatives. Bill George's article—"The DuPont Proxy Contest Is a Battle for the Soul of American Capitalism"—made the stakes clear. Other business and governance luminaries who went on the record in support of DuPont against Trian included Jay Lorsch and Jeffrey Sonnenfeld. The arguments advanced proved effective in rebutting the "what's the harm" refrain that is disappointingly all too frequent in short-slate election contests.

Finding Stockholder Champions. Through close and effective engagement, DuPont secured the public, pre-vote support of respected and influential stockholders such as CalPERs and the Canada Pension Plan Investment Board. Anne Simpson (CalPERs' Director of Corporate Governance and Senior Portfolio Manager, Investments) and CalPERs went on record criticizing the activist's thesis as "relatively short term" and expressing concern about "cost cutting which would reduce research and development."

Communicating Effectively with Index Funds and Governance and Voting Professionals. DuPont took its case directly to the index funds, traditionally "passive" investors and other governance and voting professionals throughout the campaign. In doing so, DuPont's executives and independent directors emphasized the unique needs of a global science company in the midst of strategic transformation and proof of outperformance, as well as DuPont's good governance and board practices, effective oversight by independent directors, proven commitment to long-term value creation, aligned executive compensation, and its sustainability and corporate citizenship initiatives. Although the specific impact is far from clear, DuPont also participated in forums with the Council of Institutional Investors, and Glass Lewis' "Proxy Talks," which have often been eschewed by companies in activist proxy contests.

Rapid Response Communication Tools and Media. Messaging by DuPont included a dedicated campaign website (DuPontDelivers.com), videos from the Chairman and CEO and the Lead Director, targeted advertisements, effective use of national and local press and industry

outlets, tailored proxy materials and investor presentations and CEO participation in interviews and magazine profiles with leading publications.

Setting the Record Straight. In the face of frequent "white papers" and aggressive critiques from Trian, DuPont responded comprehensively and in real-time (in the same news cycle) using a variety of methods. These included timely infographics, rebuttals, presentations and letters that presented objective evidence of the company's strong performance and exposed misleading and incomplete claims and analyses by the activist. DuPont also cultivated sell-side analysts effectively.

Engaging with the Activist—and Carefully Considering Their Ideas. Nearly two years of engagement between DuPont and Trian enabled the company to fully evaluate the activist's proposals. It also allowed DuPont to demonstrate that it was genuinely open to engagement (including settlement possibilities) and to considering new ideas. But once the Board concluded that at least some of the recommendations were ill-advised and that fundamental disagreements on business strategy made a settlement on the terms sought by the activist unacceptable, the company relentlessly made its case for why it would not adopt what it considered a "value-destructive, high-risk" agenda to "break up DuPont, burden it with excessive debt and destroy value."

Targeting the Retail Vote. The very high percentage (over 30%) of shares held by retail shareholders, including some former employees, made retail vote turnout a top priority; DuPont used a variety of creative methods to reach this constituency.

Maintaining Employee Morale and Staying Focused on the Business. Every constituency matters in a proxy contest, and DuPont went to great efforts to preserve the focus and loyalty of its employees using employee-specific messaging and other methods. In addition, DuPont worked hard to minimize the distraction of a proxy fight and to preserve management's focus on business execution.

Investing in Innovation. Activist attacks against R&D and other capital expenditures targeted at innovation are likely to increase. Effectively explaining why R&D matters and why a company's board and management can be trusted to be thoughtful and objective regarding R&D-focused investment remains critical for science and technology companies.

BlackRock's CEO Larry Fink's message to publicly traded companies is worth keeping in mind: "It is critical, however, to understand that corporate leaders' duty of care and loyalty is not to every investor or trader who owns their companies' shares at any moment in time, but to the company and its long-term owners. Successfully fulfilling that duty requires that corporate leaders engage with a company's long-term providers of capital; that they resist the pressure of short-term shareholders to extract value from the company if it would compromise value creation for long-term owners; and, most importantly, that they clearly and effectively articulate their strategy for sustainable long-term growth. Corporate leaders and their companies who follow this model can expect our support."