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Mergers & Acquisitions 2020

A practical cross-border insight into mergers and acquisitions

14th Edition

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Group Publisher
Rory Smith

Senior Editors
Suzie Levy
Rachel Williams

Sub Editor
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Contributing Editors:
Lorenzo Corte & Scott C. Hopkins
Skadden, Arps, Slate, Meagher & Flom (UK) LLP

Expert Chapters

Q&A Chapters

The New Dealmakers and Dealbreakers: M&A Activism


Adam O. Emmerich


Trevor S. Norwitz

Wachtell, Lipton, Rosen & Katz

Introduction

Shareholder activism continues to be a major feature of the global corporate landscape, with 209 activist campaigns against sizeable companies launched globally in 2019.[i] While the aggregate number of campaigns is down from the record number set in 2018, activism relating to merger, acquisition, break-up and similar transactional activity has continued to increase, with nearly half of all campaigns in 2019 having an M&A thesis and over half of all capital deployed by activists centered on M&A activism.

While M&A activism has long been a tool in the activist playbook, it emerged as the dominant tactic in 2019. Five years ago, M&A activism accounted for 26% of all activist campaigns; in 2019, approximately 47% of activist campaigns had an M&A thesis.[ii] Today, activists are increasingly willing to adopt a variety of activist approaches towards M&A transactions – including pushing for a sale of or a break-up of a company and opposing vulnerable transactions – as part of or in conjunction with broader strategic and governance proposals.

Notable M&A activism campaigns in the United States in 2019 included Carl Icahn's vocal opposition to the acquisition of Anadarko Petroleum by Occidental Petroleum, Starboard Value's opposition to the acquisition of Celgene by Bristol-Myers Squibb, Pershing Square and Third Point's opposition to the merger between United Technologies Corporation and Raytheon, Mantle Ridge's push for the sale of Aramark, and Carl Icahn's push for a merger between Xerox and HP. In an evolution from the past, several of the activist campaigns in the past year have been supported by institutional investors and asset managers who have traditionally remained silent amid activist campaigns.

The escalation in M&A activism has extended beyond the United States. In 2019, activists initiated 48 activism campaigns against sizeable companies in Europe.[iii] Over $82 billion of capital has been deployed into activist campaigns in Europe. U.S.-based activists have sought to replicate their playbook abroad, issuing public letters to target boards, critiquing operational and strategic performance and engaging in proxy contests to seek board representation. The growth of activism in Europe has also produced an uptick in M&A activism. European companies that have been the target of M&A activism in 2019 include Nestlé, Merlin Entertainment, Just Eat, Pernod Ricard and Renault.

M&A activism has also grown in Asia. In 2019, Japanese companies, in particular, were under the activist spotlight: Third Point disclosed a $1.5 billion stake in Sony and called on the company to divest its stakes in several business units while Elliott Management pushed for the sale of Unizo Holdings to the Blackstone Group. The trends in Japan are evident elsewhere in the region: corporate governance is under increased scrutiny and a number of key jurisdictions, including Japan, Hong Kong and Singapore, have introduced corporate stewardship principles. Although the prevalence of family-controlled companies, shareholder deference to management and cultural opposition to public confrontation have traditionally discouraged shareholder activism in Asia, such reluctance is on the wane as activists join forces with powerful long-term investors such as local pension funds to voice their opinions on governance issues and, increasingly, strategic matters.

The growth of M&A activism in 2019 may have been, in part, fueled by the large number of mega-deals announced in the first half of 2019 – a trend that may well continue in the coming years as a number of industries continue to face pressure to consolidate. Activist funds have also seen volatile returns in the last few years and the pivot towards M&A activism reflects ongoing efforts to find new avenues for generating "alpha" (above-market returns) in an increasingly crowded activist market where first-time activists accounted for over a quarter of new campaigns in 2019.[iv] Moreover, more established activist funds, having already picked through the low-hanging fruit, are increasingly willing to adopt more complex or risky strategies, often with holding periods measured in (a few) years, rather than months. These strategic forays include stepping into the private equity space and aligning themselves with institutional shareholders and, on occasions, strategic acquirers. Going forward, companies, boards and management will need to be prepared for and remain alert to increasingly sophisticated activist campaigns, including being prepared to respond to and engage with activists in the context of a live transaction when a company's resources are already stretched thin.

The M&A Activism Playbook

M&A activism can be described as any activist strategy which is based (sometimes partially but often entirely) on one or more transactions as opposed to operational or governance changes at the company being targeted. Activist investors have typically adopted three broad theses in M&A activism campaigns: (1) pushing for an outright sale of the target company; (2) pushing for a break-up of the target, by either spinning off or divesting one or more parts of the target's business; and (3) opposing a pending transaction, which might be aimed at stopping the transaction completely or just seeking to improve the price or other terms of the deal (which, typically when conducted by activists who buy into the target's stock after a transaction has been announced, is sometimes pejoratively referred to as "bumpitrage").

Pushing for a Sale of the Target Company

The heady growth in market values and M&A volumes in the past decade has seen activists increasingly pushing for targets to announce that they are "exploring strategic alternatives" (a well understood euphemism for putting themselves up for sale), in addition to demanding operational and strategic changes to enhance shareholder value. Activist appetite for M&A is particularly noticeable among smaller to mid-sized companies with market capitalizations under $2 billion where activists have sought undervalued companies as opportunities to quickly generate sizeable returns without having to commit time and effort to reshaping the board or management. However, activists have not shied away from pushing for the sale of larger targets, particularly those that have come under performance pressures or which are already subject to rumors of a potential acquisition. For example, in 2019, activist funds Sachem Head and Starboard Value successfully pushed for the sale of Zayo Group Holdings to Digital Colony Partners and EQT Partners for $8.2 billion. Similarly, Carl Icahn urged the struggling Caesars Entertainment to sell itself to El Dorado Resorts for approximately $8.6 billion. In both instances, the activists were able to realize a sale within a matter of months and pocket a sizeable premium in the process. For the target companies, the public involvement of an activist only intensified pressure and public scrutiny to enter into a sale process, even as management and the board sought to consider all strategic alternatives.

Starboard Value and Sachem Head's push for Zayo's sale concluded quickly without much public confrontation (following Zayo's market capitalization plummeting by more than a quarter in the preceding 12 months amid poor revenue growth and heavy capital expenditure). Sachem Head and Starboard Value exited their positions in Zayo before the deal was even consummated. On the other hand, in the case of Caesars Entertainment, Carl Icahn demonstrated again that some activists remain willing to adopt a more heavy-handed approach to furthering their goals. After disclosing a substantial stake in Caesars (about 18% directly and another 11% in derivative holdings), Icahn had a number of his designees installed on the Caesars board of directors and into a control position on a newly formed strategic transactions committee, where they pushed for a sale to El Dorado Resorts. As an illustration of the kind of pressure an activist can exert in these situations, a leak by "inside sources" noted that Icahn was prepared to accept a lower price than that demanded by the rest of the board.

Pushing for Divestitures or Spin-offs

Pushing for a sale or spin-off of a portion of a target company's business is another tactic favored by activists. The typical rationale given is that businesses which do not have compelling synergies when operated together should be run by separate management teams who are more focused and whose compensation can be more closely aligned with their performance. In addition – and this rationale is often unspoken – when a large complex company is separated into "pure-play" pieces, each part becomes both more digestible and more likely to be attractive to potential acquirers.

A divestiture of a business can provide activists with a quick profit from the stock price appreciation (and potentially special dividend) resulting from the influx of cash, as well as further appreciation in the target company's stock price from increased investor confidence in the operations of the remaining streamlined business. A spin-off of part of a target company may be a more tax-efficient way to unlock value by separating underperforming or undervalued, loosely connected businesses, and also increases the likelihood of a sale of the separated parts. In such case, careful tax planning is necessary to ensure that discussions regarding possible transactions do not impact the tax treatment of the spin-off.

One of the most high-profile examples of an activist-led push for a divestiture, which can be said to illustrate both sides of the activist coin, was Carl Icahn's campaign for the spin-off of PayPal from eBay. In January 2014, Icahn acquired a toehold stake in eBay and promptly demanded that eBay spin off PayPal, its largest business unit, while also demanding that two of his associates be appointed to the eBay board of directors. eBay had acquired PayPal in 2002 for $1.5 billion and grown it into a much larger business by leveraging its own marketplace businesses and global presence. In the subsequent public polemic, eBay explained that its board had in the past considered spinning off PayPal and believed that a separation would be appropriate at the right time but disagreed with Icahn as to whether immediate separation was appropriate. After an aggressive proxy campaign, in which Icahn attacked members of the eBay board personally with dubious allegations, and in which the two sides feuded extensively on social media, the parties settled the matter, with Icahn dropping his separation proposal and eBay agreeing to add a mutually agreeable director. The very next year, however, eBay's board revisited the separation question and determined that the time was now right for a spin-off of PayPal. While market and competitive developments (including Apple unveiling its own online payments system) were certainly major factors in the board's decision, it would be fair to surmise that Icahn's bruising proxy campaign and changes in the company's shareholder base were also considerations. When its spin-off was completed in July 2015, PayPal had a market capitalization of $36 billion (making it the largest ever tech spin-off). Subsequently, PayPal's market capitalization has grown to $130 billion. It could be said that Icahn was right and his aggressive activism led to the creation of substantial value, or alternatively, that the board had made excellent decisions with respect to PayPal up to that point, and would have made the right decision without the divisiveness of a belligerent public battle which was ultimately only about the timing of a separation.

Activist pushes for spin-offs have remained in the news in 2019, including with regard to eBay itself. Beginning early in 2019, activist funds Elliott Management and Starboard Value pushed eBay to conduct a review of its StubHub and eBay Classifieds businesses. In November, after the activists had installed designees on the eBay board, eBay announced that it was selling StubHub, which it had purchased in 2007 for $310 million, to Viagogo for over $4 billion. Meanwhile, activist fund Third Point renewed its calls for Nestlé to divest its stake in L'Oréal and to dispose of its non-core business assets, including its U.S. confectionary business and its skincare health unit. Third Point's campaign against Nestlé formed part of a broader package of proposals that the activist has pushed for since initiating its campaign in 2017. The Nestlé campaign reflects the willingness of activists to undertake complex multi-year campaigns where divestitures form part of a multi-prong strategy to boost stock performance. Also, late in 2019, Elliott disclosed a $3.2 billion stake in AT&T (a company with a market capitalization at the time of approximately $278 billion) and issued a public letter to the board in which it questioned AT&T's acquisitions of DirecTV and Time Warner and called on the company to divest its non-core business operations including DirecTV, its Mexican wireless operations and pieces of its wireline footprint, among other strategic and operational changes. Elliott's campaign came amid flagging AT&T share

performance following its acquisition of Time Warner. While AT&T agreed to a suite of operational and strategic changes, including refraining from engaging in any further large acquisitions and agreeing to evaluate past acquisitions with a possible view to future divestitures, it remains to be seen if Elliott will make another push for divestitures or other strategic or management transformation at AT&T.

Opposing Transactions and Engaging in Bumpitrage

The risk of activist opposition to a transaction, from either the sell-side or the buy-side, is one that dealmakers need to anticipate and prepare to address. This is generally only an issue on the buy-side if the transaction is to be submitted to the acquiring company's shareholders for approval, (although as observed in the Occidental-Anadarko situation this is not a universal rule, and the very act of structuring a large acquisition in a manner that does not require shareholder approval may be the subject of an activist engagement).[v]

On the sell-side, the possibility that shareholders might not vote for the deal has long been recognized as a risk but was traditionally only considered a serious threat if a competing transaction emerged. After all, if a company is being acquired at a premium to the trading price of its shares on the recommendation of the company's board of directors, why would a majority of the shareholders decline to approve that deal? Similarly on the buy-side, a shareholder turndown was only considered a real risk if someone made an unsolicited bid for the buyer itself, thereby asking shareholders to choose between approving the acquisition transaction submitted to them by the board, or receiving a premium for their shares.[vi] Historically, in the absence of an interloper, parties to transactions could have high confidence that the shareholders would vote in accordance with the board's recommendation.

The development of shareholder opposition to a transaction in the absence of a competing offer first manifested on the sell-side. In European jurisdictions where a buyer must receive the support of 90% and sometimes even 95% of the shareholders to effect a complete merger and squeeze-out of the minority shareholders, the building and utilization of "blocking stakes" has long been a favored strategy, especially by competing bidders. In the United States, where the usual vote standard is "majority rule" (or if there is a super-majority requirement it is typically no more than two-thirds), it was traditionally prohibitively expensive for dissatisfied shareholders to build a blocking stake, and collective action problems and legal standards relating to action in unison prevented such shareholders from acting together to contest transactions. The emergence of shareholder activists, liberalization of the rules regarding communication among shareholders, and evolution of the standards for judicial consideration of conflict transactions have changed this picture.

One of the earliest high-profile instances of M&A shareholder activism occurred in connection with Novartis' acquisition of the public holdings of Chiron in 2006. Novartis had long been a large minority shareholder of Chiron, the world's leading manufacturer of influenza vaccines, owning over 40% of the company and having a couple of representatives on its board. After manufacturing glitches in one of Chiron's facilities in the UK and the subsequent shortage of flu vaccines in the U.S., Chiron's stock plummeted. Novartis decided to take Chiron private, negotiated a price with Chiron's independent directors, and then chose voluntarily to submit the transaction for the approval of a majority-of-the-minority non-Novartis shareholders, thereby neutering its own votes. Following the announcement of Novartis' bid, knowing that Novartis would have to protect its investment and had the ability to "fix" Chiron's problem, activist fund ValueAct Capital doubled its stake in Chiron and opposed the buyout. When ValueAct convinced a large long-term institutional shareholder to join its revolt, the opposition voting block forced Novartis to raise its bid from $45 per share to $48 per share. The bumpitrage business was, if not born, substantially boosted.

Historically, large or even controlling shareholders did not neuter their own votes in a transaction, because the legal structure did not give them very much benefit for doing so. Under longstanding Delaware case law,[vii] any conflict transaction – especially the squeeze-out of minority shareholders by a controlling party – was to be evaluated by the courts under the exacting "entire fairness" standard, which required both a fair process and a fair price. Whether the controlling party negotiated the deal with independent directors or submitted it to independent shareholder approval,[viii] or both, the best they could get from the courts was a shift in the burden of demonstrating the fairness of the transaction. For this reason, many conflict transactions were not submitted to a majority-of-the-minority vote.

Changes in Delaware case law in recent years allowing acquiring controllers to get the benefit of business judgment rule deference if they both negotiated the transaction with independent directors and submitted it to informed independent shareholder approval, and allowing the dismissal of plaintiffs' damages claims (absent a conflicted controller) if the transaction was approved by the informed vote of independent, un-coerced shareholders,[ix] has led to many more transactions being submitted to a majority-of-the-minority (or independent) shareholder vote. This creates rich opportunities for shareholder activists.

The recent past has seen several instances of activists seeking to block pending transactions or to improve their terms. Among the most famous of these were the multi-round bumpitrage battles Carl Icahn fought over Dell. In 2013, he opposed the $25 billion take private of Dell Inc. by Michael Dell and private equity firm Silver Lake. Although his legal tactics failed to block the deal, he did manage to force a modest price bump out of the buyers. Five years later, Icahn forced a much more substantial price increase when Dell announced a $22 billion buyout of the public investors in the VMware tracking (which was created to help Dell buy EMC in 2016) in a complex transaction that brought the company back to the public stock market. Similarly, across the Atlantic, in 2016, Elliott pushed AB InBev to sweeten its offer for rival SABMiller by £1 per share after building a 1.3% stake in the target company. Elliott also acquired a 23% stake in Poundland, thereby prompting South African retailer Steinoff to increase its offer for Poundland by 5p per share.

In recent years, shareholder activists have also been challenging transactions on the buy-side. Companies announcing large acquisitions often suffer an immediate fall in their stock price. This decline may, in some cases, be sustained if their shareholders do not see the value of the transaction or think it is just an exercise in "empire-building". Very often, however, the immediate pressure on the buyer's stock is more short-term, driven by immediate concerns regarding share dilution, management distraction, or an unexpected change in strategy which may lead some investors to realign their portfolios. This effect is often exaggerated by computer-generated trading. In its simplest terms, if a buyer's stock drops on the announcement (or premature leak) of a proposed acquisition, an activist who can buy in at that depressed price and then agitate to cause the termination of the transaction, should be able to see a nice near-term rise in the stock. Short-term investors can also play both sides. Because the announcement of a premium transaction

will invariably lead to a bump in the stock price of the target company, an activist can also profit by shorting the stock of the target company while simultaneously seeking to block the transaction on the buy-side.

In many cases, the public disclosure of activist opposition to a deal alone is sufficient to result in a fall in the target company's stock price. For example, Carl Icahn's attempt to block Cigna's acquisition of Express Scripts in 2018, though ultimately unsuccessful, resulted in Express Script's stock price tumbling 6.3% upon news of Icahn's opposition to the transaction. In early 2019, Carl Icahn publicly opposed the acquisition of Anadarko Petroleum by Occidental Petroleum. Occidental's stock price hit a 14-year low following the announcement of its acquisition of Anadarko and Icahn's campaign against the transaction. Icahn sought, but failed to receive, the backing of the Delaware Court of Chancery for his statutory books and records request seeking information on Occidental and Berkshire Hathaway, which had agreed to acquire preferred shares in Occidental to support the acquisition. Although the transaction closed, Icahn has yet to withdraw his launch of a proxy fight at Occidental's 2020 annual meeting. Instead, it appears that Icahn has hedged his bets, selling down one-third of his stake in Occidental following the Delaware ruling against him.

Other prominent examples of activist intervention on the buy-side in 2019 included Starboard Value and Wellington Management's campaign against the Bristol-Myers' acquisition of Celgene, and Pershing Square and Third Point's opposition to the merger of United Technologies and Raytheon. Starboard Value acquired a toehold stake in Bristol-Myers after the announcement of its deal to acquire Celgene, and publicly criticized the move as risky and strategically defensive, calling on the company to consider other strategic alternatives, including selling itself. In a surprise move, Wellington Management, a large institutional investor, joined Starboard Value, arguing that there were other ways to create shareholder value. Starboard sought to launch a proxy fight with five director nominees but withdrew its proxy after it failed to secure sufficient shareholder backing and the support of proxy advisors Institutional Shareholder Services and Glass Lewis, both of which recommended shareholders vote in support of the transaction. The significant shareholder overlap between Bristol-Myers and Celgene may have left key shareholders less concerned that Bristol-Myers might have overpaid for Celgene.

When United Technologies Corporation's merger with Raytheon was announced earlier this year, it was also met by opposition from activists who, while supportive of UTC exploring strategic alternatives, opposed the transaction. On the eve of the deal announcement, Pershing Square sent an email to UTC's Chief Executive Officer questioning the strategic logic of the transaction and noted that the transaction price did not properly reflect the anticipated increase in UTC's stock price following the completion of the spin-offs of its Otis and Carrier businesses. Third Point also issued a letter to the board of UTC in which it also questioned the "issuance of stock at a discounted valuation" and noted that the "merged entity would be difficult to value and trade at a lower multiple" than if UTC remained a standalone entity. Third Point and Pershing Square have since respectively sold down and exited their stakes in UTC after failing to secure broader shareholder support against the transaction.

The Factors Fueling Growth in M&A Activism

The surge of mega deals in the first half of 2019 is one factor that has driven growth in M&A activism. In the first quarter of 2019, there were 19 announced deals valued at $10 billion or greater, up from an average of six in the previous years. In an era where size and scale have become increasingly important, companies are choosing to buy assets instead of investing in research and development, credit is still historically cheap, corporate cash holdings are at historic highs, and companies are threatened by technological disruption, this phenomenon is likely to continue or even increase.

The growth of mega-deals comes with increased deal risk as larger deals historically have had higher rates of deal failure and face greater regulatory scrutiny. The challenges continue after closing, as management grapples with the task of integrating two companies with vast operational structures and cultures. Shareholders wary of the risks of high-stakes mega-mergers and fearful of an economic slowdown on the horizon have become increasingly vocal in their opposition to mega-deals. Indeed, asset managers who have traditionally remained passive are now increasingly willing to join forces with activist funds in publicly expressing their opposition to the strategic rationale of large transactions. In 2019, Wellington Management and Dodge & Cox backed Starboard Value in its opposition to the Bristol-Myers' acquisition of Celgene, while Occidental's acquisition of Anadarko prompted T. Rowe Price to align itself with Carl Icahn against the deal. In Europe, Fidelity International and Legal and General joined activist Odey Asset Management in demanding Barrick Gold Corp. offer a higher price for Acacia Mining.

Mega-deals are also prime targets for activists seeking to engage in bumpitrage. While activists rarely succeed in scuttling a deal entirely, a high-stakes transaction provides an ideal opportunity for activists (and increasingly institutional shareholders) to demand a higher price. More often than not, the cost to the acquirer of terminating a large deal, both in monetary terms and in terms of strategic disruption, is far higher than the cost of increasing the price paid to the target shareholders. As a result, acquirers may be inclined to yield to the activist's demands in order to get the deal through. In 2019, approximately one-third of all activist campaigns involved activists seeking to scuttle or sweeten a deal, an increase from 2018 and 2017 where such campaigns accounted for 28% and 23% of all M&A activism, respectively. Going forward, activists will likely continue seeking shareholder support to engage in bumpitrage, with mega-deals being prime targets as investors continue to be suspicious of rosy synergy estimates, the high costs of integration, and the continued risk of an economic downturn.

The number of activist funds has continued to grow year over year, with first-time funds accounting for a quarter of all new activist campaigns in 2019 – a pattern consistent with trends over the past five years.[x] In the meantime, activist funds have continued to experience lean returns with significant volatility in quarterly performance. The AUM of activist hedge funds also shrank in 2018, continuing a three-year trend, before recovering modestly in 2019. As easy targets become increasingly scarce and returns remain concentrated among a small number of activist firms, activists have become willing to adopt more aggressive and complex strategies. M&A activism will likely continue to appeal to activists given its flexibility and the variety of avenues for generating profits in often short time frames at various points in the economic cycle. When it comes to M&A activism, activists have the ability to shift between a variety of demands and strategies, to play different sides, and to partner with a range of third parties, whether they be strategic acquirers, hostile bidders or discontented institutional shareholders.

A further factor that is driving the growth of M&A activism is the gradual blurring of the lines between activists and private equity investors, and in some cases, even strategic acquirers. As activists become increasingly involved in shaping the strategic

operations of their target companies and demonstrate increased willingness to make longer-term investments, activism and private equity have begun to converge. Such convergence is fueled by the fact that undervalued activist targets are also often prime buyout targets. Larger, well-capitalized activist funds including Elliott, Carl Icahn, Trian and Starboard Value are increasingly teaming up with private equity funds, or, in the case of Elliott and Icahn, establishing their own private equity arms. Recent examples of activist investors adopting the tactics of their private equity counterparts include Starboard Value's $200 million strategic investment in Papa John's, Elliott's joint $5.7 billion co-investment with Veritas Capital in Athenahealth (which occurred after Elliott launched a campaign to push the company to sell itself), and Elliott and Apollo Global Management's attempted $15 billion buyout of Arconic. Private equity funds are increasingly adopting the strategies of activist funds when approaching potential targets. Firms including KKR, Golden Gate Capital and Sycamore Partners have all adopted the tactic of acquiring a toehold stake in target companies as a tool to engage the board and management on a potential buyout. With private equity investors awash in cash and increasingly struggling to find investment opportunities, their adoption of activist-style tactics is likely to continue. The gradual convergence of private equity and activism will likely bring more players into the field of M&A activism in the coming years, as both activists and private equity funds seek opportunities and funding from an overlapping pool of targets and investors.

A few years ago, when activist hedge fund Pershing Square and serial acquirer Valeant teamed up using an unusual and untested structure to make a hostile bid for Allergan (with the former buying a substantial block of Allergan shares in advance of the announcement to support the Valeant bid), it seemed as though activist collaborations with strategic acquirers would become commonplace. The unfortunate results of that investment and attempted takeover, in legal and financial terms for both Pershing Square and Valeant, appeared to have discouraged imitators for some time. Activists still do, however, team up with companies in which they are invested to pursue transactions, a recent example being presented by Carl Icahn's push for a merger between Xerox and HP.

Finally, institutional investors have also become increasingly vocal in recent years. Traditionally, if institutional investors lost faith in a company or management team, their ultimate resort would be to the use "Wall Street Walk", that is, they would sell their shares and take their money elsewhere. But that was a time when institutional investors were smaller and more nimble. Today, many funds are too large to sell their shares easily without negatively impacting the stock price, and many are passive (index funds) and are not able to make sell decisions at all. Companies and their directors are also more vulnerable today (with the elimination over the last 20 years of governance structures like staggered boards that provided them a measure of insulation from shareholder preferences) and more open to engagement with investors. Up until recently, institutional investors preferred to have that engagement quietly in the background, and while they might resort to agitating for activist involvement if sufficiently frustrated, they seldom wanted that fact to be public. In a break from the past, a number of asset managers have recently publicly called on underperforming companies to consider strategic alternatives, including selling all or part of the company.

In one prominent example, Neuberger Berman engaged in aggressive agitation with the board and management of Whole Foods Market, before Jana Partners commenced its activist campaign that ultimately led to Whole Foods being acquired by Amazon. It is unclear whether Neuberger Berman was actually coordinating with Jana (in which it owns a large minority interest) or more generally agitating for activist involvement.[xi] The relatively recent phenomenon of investors agitating for activism is sufficiently common that it has earned its own acronym – the RFA (or "Request for Activism"). Whole Foods was one of the first cases in which the traditionally passive institution proudly touted its aggressive agitation. In 2019, Wellington Management, one of Bristol-Myers' largest shareholders issued a public statement opposing its acquisition of Celgene. Dodge & Cox, another shareholder, also publicly disclosed that it was unhappy about the deal. In both instances, the institutional holders acted ahead of (and supposedly independently of) activist investor Starboard Value in expressing their opposition to the deal. The moves underscore the readiness of asset managers to actively engage with companies on their strategic operations – a significant change from only a few years ago when most remained passive or acted behind the scenes.

The largest institutional investors, BlackRock, State Street and Vanguard have all established their own proxy voting policies on a variety of governance issues and have not shied away from aligning themselves with activists on occasion. For example, BlackRock, CalPERS and State Street aligned themselves with Trian in its campaign to restructure Procter & Gamble, while the Florida State Board of Administration and Ontario Teachers' Pension Plan threw their support behind Pershing Square in its proxy fight against ADP. Other institutional investors have taken an even more proactive approach: Neuberger Berman nominated four directors to the board of Verint earlier this year while M&G Investments sought and obtained two board seats at Methanex.

It is likely that institutional investors will regularly become part of a growing number of interests shaping the strategic direction of companies, including when and how they choose to engage in M&A. The dynamics of these engagements are likely to continue to evolve, however. In particular, the impact of political pressure on the corporation to serve the interests of stakeholders other than shareholders and developing norms of corporate responsibility and focus on sustainable long-term value creation for shareholders and other stakeholders remains something of a wild card in shaping the role of activists, institutional shareholders, managements and boards, and other stakeholders in the context of ongoing strategic and tactical planning and execution, M&A, and activism. Well advised boards of directors will continue to carefully monitor and participate in the evolution of governance and stewardship norms, expectations and requirements.

Preparing for and Responding to M&A Activism

As M&A activism becomes an increasingly prominent tool in the activist playbook, companies and their boards should remain prepared for scrutiny from activist investors, institutional shareholders and potential acquirers. No company should consider itself immune from M&A activism. In preparing to successfully respond to M&A activism, companies, their boards and management should regularly review advance preparation strategies with their external advisers and keep abreast of the M&A landscape in their industry and the goals and strategies of activist investors and their potential partners and allies, including major shareholders and potential acquirers. When faced with activist scrutiny over an M&A transaction, companies ought to be prepared to explain their rationale behind their strategic and operational decisions, while also maintaining effective lines of communication with key stakeholders. And in the event the company finds itself under pressure to pursue strategic

alternatives, including the sale of the company or parts of its business, the board should be aware of its duties and responsibilities and prepared to evaluate potential responses.

Advance preparation is critical for effectively responding to activists, particularly in the context of a pending transaction when the company's resources are already stretched and the board and management are under pressure to juggle a variety of challenges. 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 in play. In addition to regular portfolio reviews by management, an annual "fire drill" involving the board and advisers is an important preparation. Companies are also well advised to engage on a regular and open basis with their key investors, with the CEO and CFO having regular contact with the key portfolio managers and analysts, and directors being prepared to participate directly in engagement in appropriate cases. When reviewing their strategy and business portfolios, companies and their management should step inside the shoes of the activists and rigorously consider whether the company could be subject to an activist campaign, and if so, evaluate the potential tactics and theses that could be launched against the company. Companies should also consider forming internal teams equipped to immediately respond to an emergent activist campaign. Such teams should be composed of key executive officers and advisers who can keep the board up-to-date on new developments and quickly convene a special board meeting if needed.

Engagement with shareholders is a key element of activism preparedness. Companies and their management ought to be familiar with the governance policies of their key institutional investors and regularly seek collaborative engagement to identify areas of potential concern. Taking a proactive approach with investors will help management understand and identify possible blind spots in the company's strategic and operational activities and build strong channels for communication in the event an activist campaign breaks out. With activist shareholders increasingly willing to make longer-term investments in their target companies and institutional investors increasingly focused on the ability of companies to address issues such as sustainability, ESG, corporate social responsibility and investment for long-term growth and value creation, companies should consider aligning their shareholder engagement efforts to address how the company's strategic and operational goals are aligned with such issues.

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Endnotes

i. Lazard. Data reflects campaigns conducted by activists globally at companies with market capitalizations of greater than $500 million at the time of campaign announcement.

ii. Lazard.

iii. Lazard. Data reflects campaigns conducted by activists at European companies with market capitalizations of greater than $500 million at the time of campaign announcement.

iv. Lazard.

v. In the US, public company mergers and acquisitions are most typically effected by means of a triangular merger structure, in which the buying company itself is not a party to the merger but has a specially-formed subsidiary merge with the target company leaving the target as a subsidiary of the buyer. In those transactions, the shareholders of the buyer are not required under state merger laws to vote for the merger, but their approval will be required under stock exchange rules if they are issuing 20% or more of their equity in the deal.

vi. That is, of course, what happened in the original transaction between Time and Warner, when after they had announced their plan to merge, Paramount made an unsolicited bid to acquire Time. The parties renegotiated to restructure the transaction as an acquisition of Time by Warner, so that the Time shareholder would not get to vote on the deal.

vii. *Kahn* v. *Lynch Communication Systems, Inc.*, 638 A.2d 1110 (Del. 1994) and *Weinberger* v. *UOP, Inc.*, 457 A.2d 701 (Del. 1983).

viii. *Kahn* v. *M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

ix. *Corwin* v. *KKR Financial Holdings, LLC*, 125 A.3d 304 (Del. 2015).

x. Lazard.

xi. Because federal securities laws require parties acting in concert with respect to investments to disclose their arrangements and plans once they collectively own 5% of a company, these arrangements are often deliberately vague and fuzzy.

Adam O. Emmerich focuses primarily on M&A, Corporate Governance and securities law matters. His practice has included a broad and varied representation of public and private enterprises in a variety of industries throughout the United States, and globally in connection with mergers and acquisitions, divestitures, spin-offs, joint ventures, and financing transactions. He also has extensive experience in takeover defence and corporate governance issues. Adam is recognised as one of the world's leading lawyers in the field of M&A in the *Chambers Global* guide to the world's leading lawyers, as an expert in M&A, Corporate Governance and M&A in the real estate field by *Who's Who Legal*, as an expert in both M&A and Corporate Governance by *Euromoney Institutional Investor's Guides*, respectively, to the *World's Leading Mergers and Acquisitions and Corporate Governance Lawyers*, and is one of *LawDragon*'s 500 Leading Lawyers in America.

Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019
USA

Tel: +1 212 403 1234
Fax: +1 212 403 2234
Email: AOEmmerich@wlrk.com
URL: www.wlrk.com

Trevor S. Norwitz focuses primarily on M&A, corporate governance and securities law matters. He has advised a range of public and private entities in a variety of industries in connection with mergers, acquisitions, divestitures, hostile takeover bids and defences, proxy contests, joint ventures, financing transactions and corporate governance matters. In addition to his professional practice, Trevor teaches a course in M&A at Columbia Law School, chairs the New York City Bar M&A Committee and is active on several other bar committees, and was a member of an international advisory group to the South African government on company law reform. He is a regular speaker and contributor to professional publications on topics relating to M&A and corporate governance, areas in which his expertise is recognised by *Who's Who Legal* and *Chambers*. He holds law degrees from Oxford University and Columbia Law School.

Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019
USA

Tel: +1 212 403 1333
Fax: +1 212 403 2333
Email: TSNorwitz@wlrk.com
URL: www.wlrk.com

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