



## Deal Activism

Posted by Adam O. Emmerich, Wachtell, Lipton, Rosen & Katz, on Tuesday, October 27, 2015

**Editor's note:** [Adam O. Emmerich](#) is a partner in the corporate department at Wachtell, Lipton, Rosen & Katz focusing primarily on mergers and acquisitions and securities law matters. This post is based on a Wachtell Lipton publication authored by Mr. Emmerich, [William Savitt](#), [Ronald C. Chen](#), [Edward J. Lee](#), [Sabastian V. Niles](#), and [Remi Korenblit](#). Related research from the Program on Corporate Governance about hedge fund activism includes: [The Long-Term Effects of Hedge Fund Activism](#) by Lucian Bebchuk, Alon Brav, and Wei Jiang (discussed on the Forum [here](#)), and [The Myth that Insulating Boards Serves Long-Term Value](#) by Lucian Bebchuk (discussed on the Forum [here](#)).

In today's robust M&A environment, parties to a potential merger or acquisition must anticipate and manage "deal activism." Just as all companies and boards should [prepare for shareholder activism](#) generally, deal participants should plan for the possibility that, after a deal is announced, activists may seek a higher price, encourage a topping bid for all or part of the company, dissent and seek appraisal, try to influence the combined company and its integration, or even try to scuttle a deal entirely, leveraging traditional disruptive activist campaign tactics in their efforts.

This deal activism dynamic is but one part of the broader intersection of M&A and activism. M&A is itself a frequent activist demand, such as when activists (i) try to force a company to seek a buyer; (ii) seek to encourage or pressure two companies to merge (and build stakes in both companies as part of the campaign, as Elliott has done in the pending Polycom/Mitel Networks situation and Starboard Value did at Staples/Office Depot and at Yahoo!/AOL); (iii) urge a company to engage in buy-side M&A; (iv) propose that a company sell divisions or assets to finance stock buybacks; or (v) push a spin-off with the idea of spinco becoming a takeover target.

Deal activism seeking to interfere with announced M&A may arise on either side of a transaction. For example, the pending Media General/Meredith Corp/Starboard Value/Nexstar Broadcasting situation illustrates deal activism directed at the acquiring, rather than the target, company. Of the public activist campaigns over the past five years seeking to disrupt deals involving at least one U.S. company: two-thirds involved hedge funds (which often bought in only after a deal was announced); less than one-third resulted in increased consideration for the target's shareholders, whether from the original acquiror or another buyer; and barely one in ten resulted in an abandoned deal. These trends are generally consistent with global deal activism. In most deals, the transaction is completed on the original terms notwithstanding activist attacks, with the only consequence being increased costs, uncertainty and distraction for all parties involved.

Deal activists may have little to lose, particularly when they exploit inherent deal uncertainty to buy the target's stock at a discount to the deal price and agitate for additional consideration. Even if there is no bump in transaction consideration for all shareholders, activists may still seek to

profit from holdout and hold-up tactics and extract private benefits that may come at the expense of other shareholders. Appraisal litigation seeking court-ordered “fair value” of shares plus statutory interest is also common, with appraisal arbitrage funds buying claims after a transaction is announced and special appraisal rights trusts being organized to allow investors to participate in claims. And just as U.S. investors have exported general activism abroad, U.S. hedge funds increasingly consider agitating against non-U.S. deals, often leveraging the idiosyncrasies of local laws to seek special benefits while deploying other U.S.-style tactics.

Value-creating deals nevertheless continue to be identified, entered into and consummated, even when activists are involved. Yet despite relatively little success, deal activism has real-world consequences. Increased transaction costs are now viewed as the cost of doing business and should be expected to bear on consideration offered *ex ante*. These costs include management distraction, increased public relations and proxy solicitation expenses, litigation costs in response to strike suits and premium payments to holdout activists. In the worst case, an activist seeking short-term gains in the context of a deal may result in a broken deal that would have been in the long-term best interests of the two parties. This too is a cost that a rational acquiror must factor into its decision to strike a deal in the first place. A sensible response is to explore transaction structures less susceptible to disruption by activists.

As in a traditional activist campaign, the basics of good preparedness and response include: be well-advised, plan ahead, stay focused, articulate the basis for value, address vulnerabilities, proactively communicate with all constituencies, engage especially with the investor and analyst community and be nimble.

In the special context of deal activism, key considerations include:

- Assemble a team of experienced advisors with expertise in deal execution and managing contested situations.
- At the structuring stage, carefully consider (i) when a shareholder vote would, or would not, be required and what the relevant voting or participation standard might be; (ii) whether appraisal rights need be made available; and (iii) state-of-the-art approaches for accelerating deal approval, regulatory and closing timelines, resolving antitrust concerns where applicable and prudently structuring and protecting the deal in a manner that will withstand scrutiny.
- Ensure a robust board process for evaluating the potential transaction and options and maintain a proper record of board review and deliberation.
- Consider the respective companies, deal terms and overall situation from an activist perspective, including tools and accumulation strategies activists might use and how to respond and defend against them. Anticipate possible attacks by analyzing the shareholder base and how it might change.
- Momentum is established in the first hours following a deal’s public announcement; developing and executing an effective roll-out and communications plan must be a top priority. This includes a well-crafted announcement release, compelling investor presentations and conference calls (often with key members of acquiror and target management present), and one-on-one meetings with key shareholders, regulators, business partners and other constituencies.
- Avoid premature disclosure, which impedes control of messaging and may yield avoidable opposition and interlopers. Have a strategy for preventing and managing leaks.

- Where strategic rationales drive a deal, articulate the strategic benefits clearly, forcefully and consistently. And when defending a deal against a proxy contest to replace directors, include governance-oriented messages in addition to economic arguments.
- In the context of a vote, work aggressively to win shareholder and proxy advisory firm support. Draft disclosures with that in mind, in addition to complying with legal requirements.
- Be ready to effectively manage and litigate appraisal claims and litigation-based attacks.
- Where a bidding contest is expected, encouraged or emerges, boards and shareholders can be asked to make difficult qualitative judgments about the value of a bid in hand versus a more conditional bid that might emerge at some future date. Such decisions are not always clear or easy, and technical arbitrage pressures can distort the true underlying value or likelihood of competing bids, as can short-term incentives to promote active bidding contests.

While shareholder activism is a part of modern corporate life, it should not deter boards from approving a significant acquisition or other material transaction, or rejecting a merger proposal or a hostile takeover bid, all of which is within the board's business judgment. With careful planning, effective strategies and steady execution, companies can continue to get value-creating deals done.