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Deal Activism: Lessons from the EQT Proxy Contest

"Deal Activism," in which activists invest to oppose announced deals, has become an increasingly frequent component of the activist playbook. While efforts by the target company's shareholders to oppose a deal to secure a higher bid have received the most media attention, activists have also run campaigns against acquirors to block transactions outright, to extract concessions or to generate pressure against a board. This occurs most frequently in strategic, stock-for-stock transactions where votes are needed on both sides.

The recent proxy contest over EQT Corporation's strategic merger with Rice Energy demonstrates that these fights can be fought and won. EQT is one of the largest natural gas producers in the United States, and has viewed its vertical integration of production and midstream as a source of competitive strength. At the same time, EQT has taken steps over the last five years to unlock the embedded value of its midstream businesses, including creating two listed midstream MLPs. However, a "sum-of-the-parts" valuation issue then arose, which EQT had announced would be addressed in 2018. The opportunity to acquire Rice Energy, which has a compelling adjacent geography to EQT's existing acreage, became available in 2017 – but activists complained that the transaction should be precluded until the valuation issue was resolved. After a highly visible contest for nearly four months, shareholders voted today to authorize the deal. The EQT proxy contest provides a number of valuable lessons on how companies can successfully navigate this type of activist assault.

Broad engagement with shareholders before and during the deal. EQT has a long history of dialogue with shareholders that it was able to draw upon in articulating and persuading shareholders of the benefits of the merger. It goes without saying that it is harder to get support from shareholders if the first time the company reaches out to them is when a proxy card is needed. Post-announcement, EQT engaged broadly and intensively with shareholders – the Lead Independent Director and CEO personally called on significant shareholders and proxy advisory firms, and the Board closely monitored and heard shareholder feedback. Particularly in the fog of war and the never-ending rumor mills that are attendant to activist-led proxy fights, these efforts make all the difference in building credibility for the board and management and enabling them to hear what long-term shareholders want.

Keep on message. In all deals, but especially those subject to activist challenge, a strong rollout, and staying on message throughout the process, is critical. In the course of an activist assault it is often difficult not to be distracted by the wide variety of criticisms the activists may raise, and the wide variety of "experts" whose presentations often oversimplify the many complicated and subtle judgments involved. In this often chaotic context, it is critical to maintain focus on the benefits of the deal and the credibility of the board and management. EQT introduced the transaction with a detailed investor presentation and conference call. In the face of a barrage of disparagement by activists, much of it *ad hominem*, EQT maintained its composure and continued to focus the market on the deal. EQT's Board also wisely made real, public commitments to underscore the strength of its focus on the interests of shareholders and its intention to address valuation issues. The ISS and Glass-Lewis recommendations are still important, and the Lead Independent Director and CEO personally and effectively presenting to those firms were key factors in EQT's success in obtaining their recommendations. The merger's opponents also made presentations, but ultimately failed to persuade the proxy advisory firms, and then withdrew the challenge shortly following the advisory firms' recommendations in favor of the deal.

Settlement has its place, but is not always necessary or desirable. The temptation to short-circuit the disruption and distraction of a proxy fight with a settlement is understandable and, in some circumstances, appropriate. Activists sometimes will publicize some of their settlement demands to generate support from other investors or to appear reasonable and build pressure for their platform. However, accommodating the demands of the activist may not always be what the board considers to be in the best interests of all shareholders, and companies must carefully and deliberately make this determination. In some cases, the optimal approach may be to sort out which ideas resonate broadly and proactively take actions with wide support to demonstrate responsiveness to investor concerns without acceding to the activists' more parochial demands. EQT's Board, for instance, made important, unilateral public commitments to do what it believed was right for all shareholders and not just the activists – including commitments to address valuation promptly following completion of the merger, to add two new directors with midstream experience and to move the 2018 board nomination window to provide accountability for its announcement concerning the valuation issue. Actions like this may not result in immediate peace, but can strengthen the case to institutional shareholders and proxy advisory firms that the board is open minded and doing what is best for all shareholders on a longer-term basis.

Focus on the long-term investor and the value-creation strategy. Deals are more likely to be successfully received in the face of an activist challenge when companies can contextualize them within a longer-term plan to create value. Companies should articulate the strategy to institutional investors in advance of a deal so that when a deal opportunity becomes actionable there is support. In EQT's case, activists highlighted the near-term gain that might be obtained by scuttling the merger and focusing on the valuation issues instead, and wanted assurance that the Rice merger would not detract from EQT's commitment to address this discount. EQT was able to argue that the merger would create value and the company could address valuation issues after the merger from a stronger position, so that longer-term shareholders could get the benefit of both steps. EQT's long record of executing value-enhancing transactions, consistent strategy of building geographic concentration and willingness to add directors and to address valuation following closing were no doubt reassuring to long-term investors. While the facts and circumstances of each deal are unique, shareholders generally can be persuaded that the opportunity to complete an accretive strategic transaction is worth pursuing when it complements a well-articulated long-term plan to create value.

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