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5 Ways To Avoid Being Targeted By An Activist Investor

By **Chelsea Naso**

Law360, New York (March 25, 2016, 9:06 PM ET) -- Activist campaigns don't discriminate against targets based on size or sector, and as more cash pours into funds with an activist agenda, public companies of all kinds should prepare for the change that an activist surfaces in their stock. But preparing for that likelihood can also spark crucial changes that prevents an activist from zeroing in in the first place, experts say.

Public companies concerned about activist pressure need to think proactively about the long-term plan for the company and its shareholders, or there is a strong chance they will wind up the target of a potentially disruptive and expensive activist campaign.

"Activism has become such a big part of the landscape," said Wilson Sonsini Goodrich & Rosati partner David Berger. "[Companies] best be prepared for it."

And, if an activist does arise, make sure there's a qualified team in place ready to respond.

Here, Law360 outlines five steps companies can take to help avoid being targeted by activist investors.

Embrace a Long-Term Plan

To avoid being a target of an activist campaign, public companies need to be extremely proactive in developing a strategic long-term plan that is also accompanied with projections to illustrate where the board expects the company to be over the next few years.

"There is no better defense for any company against a potential activist than developing a very strong business and strategic plan," said Skadden Arps Slate Meagher & Flom LLP partner Martha McGarry.

Once there is a plan in place, boards of directors should be regularly going over it to make sure it is still the strongest plan for the company and its shareholders, as well as being proactive in communicating the plan to shareholders, explained Eduardo Gallardo, a Gibson Dunn partner.

"It sounds simple enough, but boards in this day and age need to be continuously exploring all options to create long-term value for their shareholders," he said. "The long-term plan, the story as to why the company is doing the right things should already be out there, without the activists having to put the company in the spotlight."

Think Like an Activist Shareholder

Part of evaluating the company and its long-term plan should be weighing the pros and cons of the common themes of activist campaigns, such as stock buybacks, spinoffs or divestitures, explained Gallardo.

That review should be backed by outside opinions from advisers so that if an activist arises or if an institutional shareholder asks, there is clear evidence backing the company's view that, for instance, a buyback, a spinoff or another transaction would harm the long-term value of the company.

"If they don't make sense, you should not be doing them, but you need to be able to articulate clearly to shareholders why they do not make sense for long-term value creation for shareholders," Gallardo said.

Public companies should also take a hard look at their corporate governance practices to make sure they are on par with the recommendations of proxy advisers like ISS and Glass Lewis as that is yet another soft spot for activists to target.

It all boils down to identifying potential vulnerabilities based on areas of interest of past shareholder activist campaigns, according to McGarry.

"Companies have looked at the activist playbook, and they are confronting their own potential vulnerabilities up front. They are looking at the types of issues activists have previously targeted, such as overcapitalization, depressed stock price because of slower growth or certain parts of their business underperforming other parts," she said.

Build a Relationship With Investors

Building out a strategic plan and identifying vulnerabilities are key, but it is also essential to foster an open dialogue and build a relationship with the largest 10 to 20 institutional investors that are stakeholders in the company.

Many boards fall short in terms of forming a strategic plan and then communicating it personally to those top investors, a move that can leave the company's leadership out of touch with shareholders' concerns and breed an environment ripe for activism.

"Very few companies put out or prepare and think about a strategic plan and then go proactively sit down with their institutional investors," said Mayer Brown LLP partner James Carlson. "Most companies think that you engage with investors through the quarterly analyst calls. That is actually not the right forum for this."

Developing that relationship with the largest investors early on can also be key if an activist investor does target the company because the company's leadership will then already know whom to reach out to and has had the opportunity to communicate its story, explained Kai Liekefett, a Vinson & Elkins LLP partner and head of the firm's shareholder activism response team.

"What you don't want to happen is your major shareholders only hear from you for the first time after a shareholder activist campaign has begun," Liekefett said. "If and when you get attacked, you already have an existing relationship you can build on."

Along with building a relationship with investors, public companies should be monitoring, or relying on an outside firm to monitor, shifts in the ownership of their stock so they are not blindsided by the presence of an activist.

“Companies should be careful about monitoring movement in their stock as a way to detect hedge funds or activists,” Gallardo said.

Acquire the Best Tools

Public companies, especially those that have been public for a long time, may want to consider having someone with experience in proxy contests comb through their charter and bylaws to make sure they have all of the available tools to best fight back against a shareholder activist, noted Liekefett.

“From a legal perspective, companies should have someone who has proxy fight experience go through their charter and bylaws and just identify potential weaknesses,” Liekefett said. “You can gain a lot of tactical advantages from a legal perspective by making certain tweaks to the bylaws.”

Those advantages include preventing forum shopping in the case of litigation or laying the groundwork so a poison pill can be adopted. Certain states also have additional anti-takeover rules, such as the ability of Maryland incorporated companies to immediately stagger the board, Kunz said.

“Make sure you have a full toolkit of potential responses in your articles and bylaws,” he said. “A number of states have anti-takeover statutes that can provide certain protections.”

Any changes to the charter or bylaws, however, should be done before an activist sets its sights on a company.

“The best time to make those changes from a legal perspective and a public relations perspective is during peace time,” Liekefett said.

Ready a Response Team

Activists may target a public company for any number of reasons, and while a response team in itself will not prevent a campaign from taking aim at a company, as the old saying goes, there’s no better defense than a strong offense.

That being said, public companies should have a strong response team in place, including legal advisers, proxy advisers and financial public relations professionals who are familiar with the company and can react appropriately if an activist arises, explained Kunz.

“You really want to have those numbers in the rolodex ready to go and know what the plan is if something comes up,” he said.

Reaching out to those advisers only after an activist launches a campaign can be too little too late as the battles are often fought in the public eye, and a misstep can send the message in the wrong direction.

--Editing by Christine Chun and Kelly Duncan.